XL GROUP PLC
Form 10-K
February 28, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

S 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 1-10804

XL GROUP
Public Limited Company
(Exact name of registrant as specified in its charter)

Ireland (State or other jurisdiction of incorporation or organization)	98-0665416 (I.R.S. Employer Identification No.)
No. 1 Hatch Street Upper, 4th Floor, Dublin 2, Ireland (Address of principal executive offices and zip code)	+353 (1) 405-2033 (Registrant s telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Ordinary Shares, Par Value $0.01 per Share	New York Stock Exchange
XLIT Ltd. 5.75% Senior Notes due 2021	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 S No £

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

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 S No £

Indicate by 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 (§232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes S 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. S

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

Large accelerated filer S Accelerated filer £ Non-accelerated filer £ 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 S

The aggregate market value of the voting common equity of the registrant held by non-affiliates of the registrant on June 30, 2012 was approximately $6.4 billion computed upon the basis of the closing sales price of the ordinary shares on June 30, 2012. For purposes of this computation, ordinary shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 25, 2013, there were outstanding 294,958,080 Ordinary Shares, $0.01 par value per share, of the registrant.

Documents Incorporated By Reference

Portions of the Registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report relating to the annual meeting of ordinary shareholders to be held on April 26, 2013 are incorporated by reference into Part III of this Form 10-K.

XL GROUP PLC
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This Annual Report on Form 10-K contains Forward-Looking Statements as defined in the Private Securities Litigation Reform Act of 1995. Important factors that could cause actual results to differ materially from those in such Forward-Looking Statements are set forth herein under Item 1A, Risk Factors, and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the caption Cautionary Note Regarding Forward-Looking Statements.

PART I

ITEM 1. BUSINESS

History

XL Group plc, through its subsidiaries, is a global insurance and reinsurance company providing property, casualty and specialty products to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. We were incorporated with limited liability under the Cayman Islands Companies Act on March 16, 1998, as EXEL Merger Company. XL Capital Ltd was formed as a result of the merger of EXEL Limited and Mid Ocean Limited on August 7, 1998, and the company was named EXEL Limited on that date. At a special general meeting held on February 1, 1999, the shareholders of EXEL Limited approved a resolution changing the name of the company to XL Capital Ltd.

EXEL Limited and Mid Ocean Limited were incorporated in the Cayman Islands with principal operations in Bermuda in 1986 and 1992, respectively. On June 18, 1999, XL Capital Ltd merged with NAC Re Corp. (NAC), a Delaware corporation organized in 1985, in a stock merger.

On July 25, 2001, we acquired certain Winterthur International insurance operations (Winterthur International) to extend its predominantly North American-based large corporate insurance business globally.

Effective January 1, 2002, we increased our shareholding in Le Mans Ré from 49% to 67% in order to expand our international reinsurance operations. On September 3, 2003, we exercised our option to buy the remaining 33% from Les Mutuelles du Mans Assurances (MMA) and changed the name of Le Mans Ré to XL Re Europe S.A. On October 18, 2006, we received approval to form a new European company, XL Re Europe Ltd, based in Dublin, Ireland, which is licensed to write all classes of reinsurance business. XL Re Europe Ltd is the headquarters of the company s European reinsurance platform with branch offices in France and the United Kingdom (the U.K.).

On August 4, 2006, we completed the sale of approximately 37% of our then financial guarantee reinsurance and insurance businesses through an initial public offering of 23.4 million common shares of Syncora Holdings Ltd. (Syncora) (formerly Security Capital Assurance Ltd. or SCA). On June 6, 2007, we completed the sale of an additional portion of Syncora s common shares still owned by the company through a secondary offering and thereby reduced its ownership of Syncora s outstanding common shares further from approximately 63% to approximately 46%. On August 5, 2008, we closed an agreement (the Master Agreement) with Syncora and its subsidiaries, as well as certain counterparties to credit default swap agreements, in connection with the termination of certain reinsurance and other agreements. As part of the Master Agreement, we transferred all of the shares we owned in Syncora to a trust and, as a result, have no further ownership interest in the company.

On July 1, 2010, XL Group plc, a newly formed Irish public limited company (XL-Ireland) and XL Capital Ltd (now known as XLIT Ltd.), an exempted company organized under the laws of the Cayman Islands (XL-Cayman), completed a redomestication transaction in which all of the ordinary shares of XL-Cayman were exchanged for all of the ordinary shares of XL-Ireland (the Redomestication). As a result, XL-Cayman became a wholly-owned subsidiary of XL-Ireland. On July 23, 2010, the Irish High Court approved XL-Ireland s creation of distributable reserves, subject to the completion of certain formalities under Irish Company law. These formalities were completed in early August 2010. For further detailed information on this transaction and its impacts on shareholder rights, shareholders equity, debt and notes then outstanding and employee stock plan awards, see the company s Report on Form 8-K filed with the U.S. Securities and Exchange Commission on July 1, 2010.

For periods prior to July 1, 2010, unless the context otherwise indicates, references herein to the Company , we , us or our are to, and the Consolidated Financial Statements herein include the accounts of, XL-Cayman and its consolidated subsidiaries. For periods on and subsequent to July 1, 2010, unless the context otherwise indicates, references herein to the Company , we , us or our are to, and the Consolidated Financial Statements herein include, the accounts of, XL-Ireland and its consolidated subsidiaries.

See further information under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Segments

We are organized into three operating segments: Insurance, Reinsurance and Life operations. Our general investment and financing operations are reflected in Corporate.

We evaluate the performance of both the Insurance and Reinsurance segments based on underwriting profit and the performance of the Life operations segment based on its contribution to net income. Other items of our revenue and expenditure are not evaluated at the segment level for reporting purposes. In addition, we do not allocate investment assets of our property and casualty (P&C) operations to the other segments. Investment assets related to our Life operations and certain structured products included in the Insurance and Reinsurance segments are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these operations.

The following table sets forth an analysis of gross premiums written by segment for the years ended December 31, 2012, 2011 and 2010. Additional financial information about our segments, including financial information about geographic areas, is included in Item 8, Note 4, Segment Information, to the Consolidated Financial Statements included herein.

(U.S. dollars in thousands)	**Gross Premiums Written**			**Percentage Change**	
	2012	**2011**	**2010**	**2012 to 2011**	**2011 to 2010**
Insurance	$ 5,166,974	$ 4,824,665	$ 4,418,380	7.1 %	9.2 %
Reinsurance	2,008,156	2,073,619	1,842,951	(3.2)%	12.5 %
Life operations	355,754	394,555	411,938	(9.8)%	(4.2)%
Total	$ 7,530,884	$ 7,292,839	$ 6,673,269	3.3 %	9.3 %

Insurance Segment

General

Our insurance operations are organized into four business groups: International Property and Casualty, North America Property and Casualty, Global Professional Lines and Global Specialty Lines.

Our insurance operations provide customized insurance policies for complex corporate risks that may require large limits and are marketed and distributed through a wide variety of local, national and international producers. Large deductibles and self-insured retentions are incorporated into these policies to further manage risk along with stringent underwriting guidelines. While our insurance operations are known for insuring large complex risk, certain of our products are targeted to small and midsize companies and organizations, such as our professional liability and program business. We focus on those lines of business that we believe will provide the best return on capital over time.

The Insurance segment s most significant operating legal entities in 2012 based on revenues were as follows: XL Insurance (Bermuda) Ltd, XL Insurance Company Limited, XL Specialty Insurance Company, Indian Harbor Insurance Company, Greenwich Insurance Company and XL Insurance America, Inc., as well as certain Lloyd s syndicates.

The excess nature of many of our insurance products, coupled with historically large policy limits, results in a book of business that can have losses characterized as low frequency and high severity. As a result, large losses, though infrequent, can have a significant impact on our results of operations, financial condition and liquidity. We attempt to mitigate this risk by, among other things, using strict underwriting guidelines, effective risk management practices (e.g., monitoring of aggregate exposures) and various reinsurance arrangements, as discussed below.

International Property and Casualty (IPC)

IPC includes the following lines of business: property, primary and excess casualty and environmental liability.

Property and casualty products are typically written as global insurance programs for large and medium sized multinational companies and institutions and include property and liability coverages. Property and casualty products generally provide large capacity on a primary, quota share or excess of loss basis. Global insurance programs are targeted to large multinational companies in major industry groups including aerospace, automotive, consumer products, pharmaceutical, pulp and paper, high technology, telecommunications, transportation and basic metals. The primary casualty programs generally require customers to take large deductibles or self-insured retentions. For the excess business, our liability attaches after large deductibles, including self insurance or insurance layers provided by other companies. Policies are written on an occurrence, claims-made and occurrence reported basis. Our property business, which also includes construction projects, is short-tail by nature and written on both a primary and excess of loss basis. Property business includes exposures to man-made and natural disasters, and generally, loss experience is characterized as low frequency and high severity.

Environmental liability products include pollution and remediation legal liability, general and project-specific pollution and professional liability, and commercial general property redevelopment and contractor s pollution liability. Business is written for both single and multiple years on a primary or excess of loss, claims- made or, less frequently, occurrence basis. Targeted industries include environmental service firms, contractors, healthcare facilities, manufacturing facilities, real estate development, transportation and construction.

North America Property and Casualty (NAPC)

NAPC includes the following lines of business: property, primary and excess casualty, environmental liability, excess and surplus lines, construction, surety and program business.

In addition to the property, casualty and environmental products described under IPC, the NAPC business unit also includes 100% property products for the large account risk engineered markets and general liability, U.S. workers compensation and auto liability for the risk management accounts, which require customers to take large deductibles or self-insured retentions.

Excess and surplus lines products include general liability property, excess auto and excess liability coverages where most Insurance Services Office, Inc. (ISO) products are written. Targets include a variety of classes, including rail roads with focus on one-off risks generated by contracted wholesale brokers.

Construction products include property coverages (builders risk, contractors equipment, property and inland marine), general liability, U.S. workers compensation and commercial auto, as well as professional liability for contractors and owner, excess umbrella, subcontractor default insurance and primary casualty wrap ups.

Surety products include contract bonds, including bid, performance, payment and contractor qualification bonds, as well as commercial surety bonds, including appeal, court and qualification bonds. Products in general provide large capacity and are written on a sole surety, co-surety or shared surety basis.

Our program business specializes in insurance coverages for distinct market segments in North America, including program administrators and managing general agents who operate in a specialized market niche and have unique industry backgrounds or specialized underwriting capabilities. Products encompass mostly property and casualty coverages.

Global Professional Lines (Professional)

Professional includes directors and officers liability, errors and omissions liability, employment practices liability and technology and cyber liability coverages. Policies are written on both a primary and excess of loss basis. Directors and officers coverage includes primary and excess directors and officers liability, employment practices liability and company securities and private company directors and officers liability. Products are targeted at a variety of different

sized companies, with a heavy concentration on small to medium-sized firms when written on a primary basis. Employment practices liability is written primarily for very large corporations on an excess of loss basis and covers those firms for legal liability in regard to the treatment of employees. Errors and omissions coverage is written on a primary and excess basis.

Errors and omissions insurance written on a primary basis is targeted to small and medium-sized firms and coverage is provided for various professional exposures, including, but not limited to, architects and engineers, insurance brokers, consultants, lawyers, public entities and real estate agents.

Global Specialty Lines (Specialty)

Specialty includes the following lines of business: aviation and satellite, marine and offshore energy, fine art and specie, equine, product recall, political risk and trade credit and North America inland marine.

Aviation and satellite products include comprehensive airline hull and liability, airport liability, aviation manufacturers product liability, aviation ground handler liability, large aircraft hull and liability, corporate non-owned aircraft liability, space third party liability and satellite risk including damage or malfunction during ascent to orbit and continual operation, and aviation war. Aviation liability and physical damage coverage is offered for large aviation risks on a proportional basis, while smaller general aviation risks are offered on a primary basis. Satellite risks are generally written on a proportional basis. The target markets for aviation and satellite products include airlines, aviation product manufacturers, aircraft service firms, general aviation operators and telecommunications firms.

Marine and offshore energy coverage includes marine hull and machinery, marine war, marine excess liability, cargo and offshore energy insurance. Fine art and specie coverages include fine art and other collections, jewelers block, cash in transit and related coverages for financial institutions. Equine products specialize in providing bloodstock and livestock insurance. Product recall coverages include product contamination for the food and beverage sector and end-product consumer goods and product guarantee aimed at component part manufacturers.

In 2011, we launched underwriting capabilities for political risk and trade credit as well as North America inland marine business.

Also included as part of the Insurance segment is XL Global Asset Protection Services (XL GAPS), a fee for service loss prevention consulting service that offers individually tailored risk management solutions to risk managers, insurance brokers and insurance company clients operating on a global basis. Services are offered on an unbundled (services not tied to an insurance contract) and bundled basis.

Underwriting

We underwrite and price most risks individually following a review of the exposure and in accordance with our underwriting guidelines. Most of our insurance operations have underwriting guidelines that are industry-specific. We seek to serve our clients while controlling our exposure on individual insurance contracts through terms and conditions, policy limits and sublimits, attachment points and facultative and treaty reinsurance arrangements on certain types of risks.

Our underwriters generally evaluate each industry category and subgroups within each category. Premiums are set and adjusted for an insured based, in large part, on the industry group in which the insured is placed and the perceived risk of the insured relative to the other risks in that group. Rates may vary significantly according to the industry group of the insured as well as the insured s risk relative to the group. Our rating methodology for individual insureds seeks to set premiums in accordance with claims potential as measured by past experience and future expectations, the attachment point and amount of underlying insurance, the nature and scope of the insured s operations, exposures to loss, including natural hazard exposures, risk management quality and other specific risk factors relevant in the judgment of our underwriters to the type of business being written.

Underwriting and loss experience is reviewed regularly for, among other things, loss trends, emerging exposures, changes in the regulatory or legal environment as well as the efficacy of policy terms and conditions.

As our insurance products are primarily specialized coverages, underwriting guidelines and policy forms differ by product offering as well as by legal jurisdiction. Liability insurance is written on both a primary and excess of loss basis, on occurrence, occurrence reported and claims-made policy forms. Occurrence reported policies typically cover occurrences causing unexpected and unintended personal injury or property damage to third parties arising from events or conditions that commence at or subsequent to an

inception date, or retroactive date, if applicable, and prior to the expiration of the policy provided that proper notice is given during the term of the policy or the discovery period. Claims-made policies typically cover only claims made during the policy period or extended reporting period and are generally associated with professional liability and environmental coverages. Traditional occurrence coverage is also available for restricted classes of risk and is generally written on a follow-form basis for excess of loss coverage, where the policy adopts the terms, conditions and exclusions of the underlying policy. Property insurance risks are written on a lead or follow-form basis that usually provides coverage for all risks of physical damage and business interruption. Maximum limits are generally subject to sublimits for coverage in critical earthquake and flood zones, where we seek to limit liability in these areas.

Engineering

Property engineering for our insurance operations includes conducting on-site inspections and consulting services related to loss prevention, reviews of building plans for fire protection design, Computer Assisted Drawings (diagrams) of facilities, recommendations on how to improve site protection, reviews of existing loss prevention reports/information for underwriters, summarizing multiple sources of information into an account summary, and providing underwriters an opinion on the risk to assist with risk selection, pricing and other underwriting decisions. The property engineering team consists of staff located in over 20 countries.

Other engineering resources support casualty, environmental, specialty and construction lines and serve as internal consultants to their respective underwriting teams, assisting them with making underwriting decisions, as well as helping their customers improve their local site or account protection.

Reinsurance Ceded

In certain cases, the risks assumed by us in the Insurance segment are partially reinsured by third party reinsurers. Reinsurance ceded varies by location and line of business based on a number of factors, including market conditions. The benefits of ceding risks to third party reinsurers include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. Reinsurance ceded does not legally discharge us from our liabilities to the original policyholder in respect of the risk being reinsured.

We use reinsurance to support the underwriting and retention guidelines of each of our subsidiaries as well as to control our aggregate exposure to a particular risk or class of risks. Reinsurance is purchased at several levels ranging from reinsurance of risks assumed on individual contracts to reinsurance covering the aggregate exposure on a portfolio of policies issued by groups of companies. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for further information.

Premiums

Premium rates and underwriting terms and conditions for all lines of business written vary by jurisdiction principally due to local market conditions, competitor product offerings and legal requirements.

The following table provides an analysis of gross premiums written, net premiums written and net premiums earned for the Insurance segment for the years ended December 31, 2012, 2011 and 2010:

		2012			2011 (1)	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Ne Premi Earn**

Professional	$	1,460,025	$	1,395,704	$	1,350,328	$	1,377,560	$	1,278,724	$	1,2
Casualty		1,726,226		1,238,280		1,157,909		1,504,203		1,035,458		9
Property		782,337		483,682		489,743		858,839		499,622		4
Specialty		892,086		738,650		708,564		871,562		723,048		7
Other (2)		306,300		216,197		218,096		212,501		170,812		2
Total	$	5,166,974	$	4,072,513	$	3,924,640	$	4,824,665	$	3,707,664	$	3,6

(1) Certain reclassifications have been made to conform to current year presentation.

(2) Other includes excess and surplus, surety, structured indemnity and certain other discontinued lines.

Competition

We compete globally in the property and casualty insurance markets. Our competitors include the following companies and their affiliates: The ACE Group of Companies (ACE); Allianz SE (Allianz); American International Group, Inc. (AIG); Factory Mutual Global (FMG) for property only; The Hartford Financial Services Group, Inc. (Hartford); Lloyd s of London Syndicates (Lloyd s); The Chubb Corporation (Chubb); The Travelers Companies (Travelers); and Zurich Financial Services Group (Zurich).

Our major geographical markets for our property and casualty insurance operations are North America, Europe and Bermuda. Our main competitors in each of these markets include the following:

North America AIG, ACE, Chubb, FMG, Zurich, Travelers, CNA Financial Corporation, Hartford, Liberty Mutual Group, Arch Capital Group Ltd (Arch), W.R. Berkley Corporation, Markel Corporation and Lloyd s.

Europe Allianz, AIG, FMG, Zurich, AXA Insurance Ltd. (AXA), ACE, Lloyd s, Assicurazioni Generali, HDI-Gerling Industrie Versicherung AG and MAPFRE S.A.

Bermuda ACE, Allied World Assurance Company, Axis Capital Group, Alterra Capital, Endurance Specialty Insurance Ltd and Arch.

Marketing and Distribution

The majority of business in our Insurance segment originates via a large number of international, national and regional producers, acting as the brokers and representatives of current and prospective policyholders. This channel is supported by our Global Distribution and Network Unit, which consists of sales and marketing representatives in key markets throughout the world, representing all of our products in collaboration with the four business groups. A portion of Insurance segment business is also marketed and underwritten by general agents and a portion by independent agents acting on our behalf. Typically, all such producers, general agents and independent agents receive commission payments from us for their services, which are calculated as a percentage of the gross premium paid by the policyholder on an account-by-account basis. A certain portion of business originating from producers is submitted on a fee basis under which the producer is compensated by a fee paid to it by its policyholder client. From time to time, we also consider requests for commissions from a producer, with disclosure by the producer to the policyholder-client, where the producer receives a fee from the policyholder-client. We evaluate such requests on a case-by-case basis.

We consider requests for contingent commission arrangements where such additional commissions are based upon the volume of bound business originated from a specific producer during a prior calendar year where legal and appropriate. Such arrangements are distinct from program business where additional commissions are generally based on profitability of business submitted to and bound by us.

With regard to excess and surplus lines business, we receive submissions from licensed wholesale surplus lines brokers.

We have no implied or explicit commitments to accept business from any particular broker, and neither producers nor any other third party have the authority to bind us, except in the case where underwriting authority may be delegated contractually to selected general agents. Such general agents are subject to a financial and operational due diligence review prior to any such delegation of authority and we conduct ongoing reviews and audits as deemed necessary with the goal of assuring the continuing integrity of underwriting and related business operations. See Item 8, Note 17(a), Commitments and Contingencies Concentrations of Credit Risk, to the Consolidated Financial Statements included herein, for information on our major producers.

Apart from compensation arrangements established with producers in connection with insurance transactions, we also have engaged, and may in the future engage, certain producers or their affiliates in consulting roles pursuant to which such producers provide access to certain systems and information that may assist us with our marketing and distribution strategy. In instances where we engage producers in such consulting roles, we may compensate the relevant producers on a fixed fee basis, a variable fee basis based

upon our usage of the systems and information proffered, or through a combination of fixed and variable fees.

Claims Administration

Claims management for our insurance operations includes the review of initial loss reports, administration of claims databases, generation of appropriate responses to claims reports, identification and handling of coverage issues, determination of whether further investigation is required and, where appropriate, retention of claims counsel, establishment of case reserves, payment of claims and notification to reinsurers. With respect to the establishment of case reserves, when we are notified of insured losses, our claims personnel record a case reserve as appropriate for the estimated amount of the exposure at that time. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process.

Claims in respect of business written by our Lloyd s syndicates are primarily notified by various central market bureaus. Where a syndicate is a leading syndicate on a Lloyd s policy, its underwriters and claims adjusters will work directly with the broker or insured on behalf of itself and the following market for any particular claim. This may involve appointing attorneys or loss adjusters. The claims bureaus and the leading syndicate advise movement in loss reserves to all syndicates participating on the risk. Our claims department may adjust the case reserves it records from those advised by the bureaus as deemed necessary.

Certain of our product lines have arrangements with third party administrators to provide claims handling services to us in respect of such product lines. These agreements set forth the duties of the third party administrators, limits of authority, protective indemnification language and various procedures that are required to meet statutory compliance. These arrangements are also subject to audit review by our relevant claim department.

Reinsurance Segment

General

Our Reinsurance segment is structured geographically into Bermuda operations, North American operations, European/Asia Pacific operations and Latin American operations.

This segment provides casualty, property risk, property catastrophe, marine, aviation, treaty and other specialty reinsurance on a global basis with business being written on both a proportional and non-proportional basis and also on a facultative basis. Our lines of business within the reinsurance segment continue to focus on those that provide the best return on capital. For our Reinsurance segment, given challenging market conditions and the changing economic environment experienced since 2008 this resulted, in certain instances, in a greater emphasis being placed on short-tail lines of business.

Business written on a non-proportional basis generally provides for an indemnification by us to the ceding company for a portion of losses, both individually and in the aggregate, on policies with limits in excess of a specified individual or aggregate loss deductible. For business written on a proportional basis, including on a quota share or surplus basis, we receive an agreed percentage of the premium and are liable for the same percentage of each and all incurred loss. For proportional business, the ceding company normally receives a ceding commission for the premiums ceded and may also, under certain circumstances, receive a profit commission based on performance of the contract. Occasionally this commission could be on a sliding scale depending on the loss ratio performance of the contract. Our casualty reinsurance includes general liability, professional liability, automobile and workers compensation. Professional liability includes directors and officers , employment practices, medical malpractice and environmental liability. Casualty lines are written as treaties or programs and on both a proportional and a

non-proportional basis. The treaty business includes clash programs, which cover a number of underlying policies involved in one occurrence or a judgment above an underlying policy s limit, before suffering a loss.

Our property business, primarily short-tail in nature, is written on both a portfolio/treaty and individual/facultative basis and includes property catastrophe, property risk excess of loss and property proportional. A significant portion of the underwritten property business consists of large aggregate exposures to man-made and natural disasters and, generally, loss experience is characterized as low frequency and high severity. This may result in volatility in our results of operations, financial condition and liquidity. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

We seek to manage our reinsurance exposures to catastrophic events by limiting the amount of exposure written in each geographic or peril zone worldwide, underwriting in excess of varying attachment points and requiring that contracts exposed to catastrophe loss include aggregate limits. We also seek to protect our total aggregate exposures by peril and zone through the purchase of reinsurance programs.

Our property catastrophe reinsurance account is generally all risk in nature. As a result, we are exposed to losses from sources as diverse as hurricanes and other windstorms, earthquakes, freezing, riots, floods, industrial explosions, fires and many other potential natural or man-made disasters. In accordance with market practice, our policies generally exclude certain risks such as war, nuclear contamination or radiation. Following the terrorist attacks at the World Trade Center in New York City, Washington, D.C. and Pennsylvania on September 11, 2001 (collectively, the September 11 event), terrorism cover, including nuclear, biological, radiological and chemical has been restricted or excluded in many territories and classes. Some U.S. states require some cover for Fire Following terrorism and some countries make terrorism coverage mandatory. Our predominant exposure under such coverage is to property damage.

Property catastrophe reinsurance provides coverage on an excess of loss basis when aggregate losses and loss adjustment expenses from a single occurrence of a covered event exceed the attachment point specified in the policy. Some of our property catastrophe contracts limit coverage to one occurrence in any single policy year, but most contracts generally enable at least one reinstatement to be purchased by the reinsured.

We also write property risk excess of loss reinsurance. Property risk excess of loss reinsurance covers a loss to the reinsured on a single risk of the type reinsured rather than to aggregate losses for all covered risks on a specific peril, as is the case with catastrophe reinsurance. Our property proportional account includes reinsurance of direct property insurance. We seek to limit the catastrophe exposure from our proportional and per risk excess business through extensive use of occurrence and cession limits.

Other specialty reinsurance products include energy, marine, aviation, space, engineering, fidelity, surety, trade credit and political risk. We underwrite a small portfolio of contracts covering political risk and trade credit. Exposure is assumed from a limited number of trade credit contracts.

The segment s most significant operating legal entities in 2012 based on revenues were as follows: XL Reinsurance America Inc., XL Re Europe Limited, XL Re Ltd and XL Re Latin America Ltd.

Underwriting

Underwriting risks for the reinsurance property and casualty business are evaluated using a number of factors including, but not limited to, the type and layer of risk to be assumed, the actuarial evaluation of premium adequacy, the cedant s underwriting and claims experience, the cedant s financial condition and claims paying rating, the exposure and/or experience with the cedant, and the line of business to be reinsured.

Other factors we assess include the reputation of the proposed cedant, the geographic area in which the cedant does business and its market share, a detailed evaluation of catastrophe and risk exposures, and historical loss data for the cedant, where available, and for the industry as a whole in the relevant regions in order to compare the cedant s historical loss experience to industry averages. On-site underwriting and claim reviews are performed where it is deemed necessary to determine the quality of a current or prospective cedant s underwriting operations, with particular

emphasis on casualty proportional and working excess of loss placements.

For property catastrophe reinsurance business, our underwriting guidelines generally limit the amount of exposure we will directly underwrite for any one reinsured and the amount of the aggregate exposure to catastrophic losses in any one geographic zone. We believe that we have defined geographic and peril

zones such that a single occurrence, for example, an earthquake or hurricane, should not affect more than one peril zone. While the exposure to multiple zones is considered remote for events such as a hurricane, we do manage our aggregate exposures for such a scenario where we consider it appropriate to do so. The definition of our peril zones is subject to periodic review. We also generally seek an attachment point for our property catastrophe reinsurance at a level that is high enough to produce a low frequency of loss. We seek to limit our aggregate exposure in the proportional business through extensive use of occurrence and cession limits.

Reinsurance Retroceded

We use third party reinsurance to support the underwriting and retention guidelines of each reinsurance subsidiary as well as to seek to limit our aggregate exposure to a particular risk or class of risks. Reinsurance is purchased at several levels ranging from reinsurance of risks assumed on individual contracts to reinsurance covering aggregate exposures. The benefits of ceding risks to other reinsurers include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. Reinsurance ceded does not legally discharge us from our liabilities in respect of the risk being reinsured. Reinsurance ceded varies by location and line of business based on factors including, among others, market conditions and the credit worthiness of the counterparty.

Our traditional catastrophe retrocession program was renewed in 2012 to cover certain of our exposures. These protections, in various layers and in excess of varying attachment points according to the territory exposed, assist in managing our net retention to an acceptable level. We have co-reinsurance retentions within this program.

We continue to buy additional protection for our marine and offshore energy exposures and in 2012 increased our retentions for these lines. We continue to buy specific reinsurance on our property and aviation portfolios to manage our net exposures in these classes.

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 9, Reinsurance, to the Consolidated Financial Statements included herein, for further information.

Premiums

The following table provides an analysis of gross premiums written, net premiums written and net premiums earned for the Reinsurance segment for the last three years ended December 31:

	2012			2011 (1)		
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Ne Prem Ear**
Casualty - professional lines	$ 221,357	$ 221,357	$ 213,322	$ 217,389	$ 217,389	$ 2
Casualty - other lines	332,561	330,715	311,160	292,507	290,962	2
Property catastrophe	537,086	473,373	463,977	461,742	404,447	3
Other property	653,514	622,853	613,295	847,816	583,100	5
	169,889	153,954	147,370	156,161	141,924	1

Marine, energy, aviation & satellite											
Other (2)		93,749		82,256		92,218		98,004		87,902	
Total	$	2,008,156	$	1,884,508	$	1,841,342	$	2,073,619	$	1,725,724	$ 1,6

(1) Certain reclassifications have been made to conform to current year presentation.

(2) Other includes whole account contracts, surety and other lines.

Additional discussion and financial information about the Reinsurance segment are set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 4, Segment Information, to the Consolidated Financial Statements included herein.

Competition

We compete globally in the property and casualty markets.

Our reinsurance operations are structured geographically into business groups: Bermuda, North America, International (Europe and Asia Pacific) and Latin America. The main competitors in each of these markets include the following:

Bermuda ACE Tempest Reinsurance Ltd, AXIS Specialty Limited, Arch Reinsurance Limited, Renaissance Reinsurance Limited, Montpelier Reinsurance Ltd, Platinum Underwriters Bermuda Ltd, PartnerRe Ltd and Validus Reinsurance Ltd.

North America Berkshire Hathaway Inc., Munich Re Group (Munich Re), Swiss Reinsurance America Corporation (Swiss Re), Alleghany Corporation, Everest Re Group Ltd, Hannover Re Group (Hannover Re) and PartnerRe Ltd.

Europe and the rest of world Munich Re, Swiss Re, Lloyd s, SCOR Reinsurance Company, Hannover Re and PartnerRe Ltd.

Latin America Munich Re, Swiss Re, Mapfre Re and IRB-Brazil Re.

Marketing and Distribution

See Insurance Segment Marketing and Distribution and Item 8, Note 17(a), Commitments and Contingencies Concentrations of Credit Risk, to the Consolidated Financial Statements included herein, for information on our marketing and distribution procedures and information on our major brokers.

Claims Administration

Claims management for the reinsurance operations includes the receipt of loss notifications, review and approval of claims through a claims approval process, establishment of loss reserves for reported claims and approval of loss payments. Case reserves for reported claims are generally established based on reports received from ceding companies with additional case reserves being established when deemed appropriate. Additionally, claims audits are conducted for specific claims and claims procedures at the offices of selected ceding companies, particularly in the United States and the U.K.

Life Operations Segment

During 2009, we completed a strategic review of our life reinsurance business. In relation to this initiative, during 2009 we sold the renewal rights to certain of our businesses, sold our U.S. life reinsurance business and announced that we would run-off our existing book of U.K. and Irish traditional life and annuity business, and not accept new business. In addition, in 2010, we consummated various transactions to novate and recapture U.K. and Irish term assurance and critical illness treaties and U.S. mortality retrocession pools. In addition, during the fourth quarter of 2012, we entered into an agreement to recapture two small U.S. life reinsurance treaties.

The Life operations segment provided life reinsurance on business written by life insurance companies, principally to help them manage mortality, morbidity, survivorship, investment and lapse risks.

Prior to the decision to run-off the U.K. and Irish business, products offered included a broad range of underlying lines of life insurance business, including term assurances, group life, critical illness cover, immediate annuities and disability income. In addition, prior to selling the renewal rights, the products offered included short-term life, accident and health business. Notwithstanding these sales, the Life operations still covers a range of geographic markets, with an emphasis on the U.K., U.S., Ireland and Continental Europe.

The portfolio has three particularly significant components:

(1) The portfolio includes a small number of large contracts relating to closed blocks of U.K. and Irish fixed annuities in payment. In relation to certain of these contracts, we received cash and investment assets at the inception of the reinsurance contract, relating to the future policy benefit reserves assumed. These contracts are long-term in nature, and the expected claims payout period can span up to 30 or 40 years

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with average duration of around 10 years. We are exposed to investment and survivorship risk over the life of these arrangements.

(2) The second component of the portfolio relates to life risks (in the U.S., the U.K. and Ireland)), income protection risks (in the U.S.) and critical illness risks (in the U.K. and Ireland) where we are exposed to the mortality, morbidity and lapse experience from the underlying business, over the medium to long-term.

(3) The third component relates to the annually renewable business covering life, accident and health risks written in Continental Europe. These contracts are short-term in nature and include both proportional and non-proportional reinsurance structures. While the renewal rights for this business have been sold, the existing business remains with us.

Underwriting & Claims Administration

While the Life operations segment was closed to new business in March 2009, the pricing information below reflects how new business was acquired prior to that date and hence is relevant to the in-force portfolio of business.

Life reinsurance transactions fall into two distinct forms. The first relates to the reinsurance of an existing and closed block of risks (in-force deal), where the nature of the underlying exposure is known at the date of execution. The second relates to the reinsurance of liabilities that are yet to be written by the ceding company (new business treaty) where, provided the subsequent risks are within the agreed treaty parameters, these risks may be added to the portfolio.

The underwriting of an in-force deal is highly actuarial in nature, requiring detailed analytical appraisal of the key parameters that drive the ultimate profitability of the deal. This includes analysis of historic experience (claims, lapses, etc.) as well as the projection of these assumptions into the future.

When new business was written, in addition to the actuarial analysis required to set the terms, there was also a requirement to establish medical underwriting criteria that will apply to the new risks that may be added to the treaty. Once a treaty was accepted, there was then an ongoing need to monitor the risk selection by the medical underwriters at the ceding company and to ensure that the criteria were being met.

The Life operations team includes many members with specialized actuarial knowledge. Claims administration also relies on experienced team members and specific medical expertise, supported where required by third party medical underwriters and claims managers.

Reinsurance Retroceded

We purchase limited retrocession capacity on a per-life basis in the United States in order to cap the maximum claim arising from the death of a single individual. Cover is purchased from professional retrocessionaires that meet our criteria for counterparty exposures. Limited retrocession of fixed annuity business has been arranged to manage aggregate longevity capacity on specific deals. Limited retrocession of life, accident and health business on specific treaties written in Continental Europe has also been arranged to manage mortality and morbidity risks.

Premiums

The following table is an analysis of the Life operations gross premiums written, net premiums written and net premiums earned for the year ended December 31, 2012.

(U.S. dollars in thousands)	**2012**			**2011**		
	Gross Premiums Written	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Annuity	$ 155,255	$ 126,912	$ 126,912	$ 161,800	$ 132,232	$ 132,232
Other Life	200,499	197,520	197,547	232,755	230,130	230,786
Total	$ 355,754	$ 324,432	$ 324,459	$ 394,555	$ 362,362	$ 363,018

Additional discussion and financial information about the Life operations is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 4, Segment Information, to the Consolidated Financial Statements included herein.

Competition

In regards to the Life operations segment, the core activity is in the United States, the U.K., Ireland and Continental Europe. While we no longer compete for new business, we retain an in-force portfolio and hence view companies with similar portfolios as competitors.

For the fixed annuity business, market participants include less traditional reinsurance entities, such as Canada Life and Prudential (U.K.) together with Swiss Re, Partner Re Ltd., Scor Global Life and Pacific Life Re, among others, who have entered or re-entered this market.

Marketing and Distribution

We no longer market or distribute new products in this segment.

Life Operations Collateral Requirements

For certain blocks of Life operations business, we are required, under the terms of the relevant treaties, to hold collateral in favor of the underlying cedants. The amount of the collateral is typically determined in relation to the level that would be necessary to satisfy requirements in either the U.K. or U.S. regulatory regimes. These requirements are higher than is required under U.S. GAAP accounting requirements and hence the amounts are generally higher than the reserves reported herein. For the closed blocks of U.K. and Irish fixed annuities, under which assets were transferred to us, those assets are maintained in segregated investment portfolios subject to security and account control agreements in favor of the cedant. For the U.S. term life and income protection business, collateral is provided through a combination of letters of credit and assets held in trust to the benefit of the client.

Unpaid Losses and Loss Expenses

Loss reserves are established due to the significant periods of time that may lapse between the occurrence, reporting and payment of a loss. To recognize liabilities for unpaid losses and loss expenses, we estimate future amounts needed to pay claims and related expenses with respect to insured events. Our reserving practices and the establishment of any particular reserve reflect our judgment concerning sound financial practice and do not represent any admission of liability with respect to any claim. Unpaid losses and loss expense reserves are established for reported claims (case reserves) and incurred but not reported (IBNR) claims.

The nature of our high excess of loss liability and catastrophe business can result in loss payments that are both irregular and significant. Similarly, adjustments to reserves for individual years can be irregular and significant. Such adjustments are part of the normal course of business for us. Certain aspects of our business have loss experience characterized as low frequency and high severity. This may result in volatility in our results of operations, financial condition and liquidity.

The tables below present the development of our unpaid losses and loss expense reserves on both a net and gross basis. The cumulative redundancy (deficiency) calculated on a net basis differs from that calculated on a gross basis. As different reinsurance programs cover different underwriting years, net and gross loss experience will not develop proportionately. The top lines of the tables show the estimated liability, net of reinsurance recoveries, as at the year end balance sheet date for each of the indicated years. This represents the estimated amounts of losses and loss expenses, including IBNR, arising in the current and all prior years that are unpaid at the year end balance sheet date of the indicated year. The tables show the re-estimated amount of the previously recorded reserve liability based on experience as of the year end balance sheet date of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual years. The cumulative redundancy (deficiency) represents the aggregate change with respect to that liability originally estimated. The lower portion of the first table also reflects the cumulative paid losses relating to these reserves. Conditions and trends that have

affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies into the future, based on the tables below. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Analysis of P&C Losses and Loss Expenses Reserve Development
Net of Reinsurance Recoverables

(U.S. dollars in millions)		**2002**			**2003**			**2004**			**2005**		**2006**		**2007**
ESTIMATED LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES, NET OF REINSURANCE RECOVERABLES	$	8,313		$	10,532		$	12,671		$	17,200	$	17,900	$	18,
LIABILITY RE-ESTIMATED AS OF:															
One year later		9,250			10,800			13,785			17,090		17,475		17,
Two years later		9,717			11,842			13,675			16,828		16,631		17,
Three years later		10,723			11,849			13,607			16,155		16,441		16,
Four years later		10,738			11,860			13,258			16,067		16,064		16,
Five years later		10,710			11,680			13,236			15,796		15,667		16,
Six years later		10,642			11,794			13,068			15,448		15,500		
Seven years later		10,824			11,669			12,819			15,248				
Eight years later		10,775			11,464			12,702							
Nine years later		10,617			11,372										
Ten years later		10,534													
CUMULATIVE REDUNDANCY (DEFICIENCY)		(2,221	)		(840	)		(31	)		1,952		2,400		1,
CUMULATIVE PAID LOSSES, NET OF REINSURANCE RECOVERIES, AS OF:															
One year later	$	2,521		$	1,985		$	2,008		$	3,437	$	3,188	$	3,
Two years later		3,800			2,867			3,884			5,759		5,620		5,
Three years later		4,163			4,380			5,181			7,590		7,528		7,
Four years later		5,365			5,286			6,392			8,936		8,787		8,
Five years later		6,018			6,225			7,386			9,882		9,763		9,
Six years later		6,764			7,002			8,098			10,636		10,463		
Seven years later		7,381			7,591			8,690			11,139				
Eight years later		7,797			8,106			9,115							
Nine years later		8,249			8,463										

Ten years later	8,558

Analysis of P&C Losses and Loss Expenses Reserve Development
Gross of Reinsurance Recoverables

(U.S. dollars in millions)	2002	2003	2004	2005	2006	2007
ESTIMATED GROSS LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES	$ 13,333	$ 16,553	$ 19,616	$ 23,598	$ 22,895	$ 22,857
LIABILITY RE-ESTIMATED AS OF:						
One year later	$ 15,204	$ 18,189	$ 19,987	$ 23,209	$ 22,458	$ 21,803
Two years later	16,994	18,520	19,533	22,937	21,337	21,445
Three years later	17,210	18,324	19,525	22,139	21,057	21,305
Four years later	17,048	18,362	19,153	21,992	20,787	20,853
Five years later	17,106	18,236	19,099	21,835	20,350	20,509
Six years later	17,051	18,328	19,050	21,426	20,117	
Seven years later	17,189	18,321	18,766	21,186		
Eight years later	17,253	18,083	18,605			
Nine years later	17,072	17,895				
Ten years later	16,905					
CUMULATIVE REDUNDANCY (DEFICIENCY)	(3,572)	(1,342)	1,011	2,412	2,778	2,348

The following table presents an analysis of our paid, unpaid and incurred losses and loss expenses and a reconciliation of beginning and ending unpaid losses and loss expenses for the years indicated.

Year ended December 31, *(U.S. dollars in thousands)*	**2012**	**2011**	**2010**
Unpaid losses and loss expenses at the beginning of the year	$ 20,613,901	$ 20,531,607	$ 20,823,524
Unpaid losses and loss expenses recoverable	3,629,928	3,649,290	3,557,391
Net unpaid losses and loss expenses at the beginning of the year	16,983,973	16,882,317	17,266,133
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:			
Current year	4,081,377	4,363,258	3,584,662
Prior years	(315,895)	(284,867)	(372,862)
Total net incurred losses and loss expenses	3,765,482	4,078,391	3,211,800
Exchange rate effects	156,206	(130,533)	(125,107)
Less net losses and loss expenses paid in respect of losses occurring in:			
Current year	416,844	589,870	442,262
Prior years	3,366,398	3,256,332	3,028,247
Total net paid losses	3,783,242	3,846,202	3,470,509
Net unpaid losses and loss expenses at the end of the year	17,122,419	16,983,973	16,882,317
Unpaid losses and loss expenses recoverable	3,361,702	3,629,928	3,649,290
Unpaid losses and loss expenses at the end of the year	$ 20,484,121	$ 20,613,901	$ 20,531,607

Our net unpaid losses and loss expenses relating to our operating segments at December 31, 2012 and 2011 were as follows:

(U.S. dollars in thousands)	**2012**	**2011**
Insurance	$ 11,384,855	$ 11,374,315
Reinsurance	5,737,564	5,609,658
Net unpaid losses and loss expenses	$ 17,122,419	$ 16,983,973

Current year net losses incurred

Current year net losses incurred decreased by $281.9 million in 2012 as compared to 2011. This was mainly as a result of the current year loss ratio excluding prior year development decreasing by 11.1 loss percentage points due to lower losses from natural catastrophes as compared to 2011. In addition, the current year loss ratio excluding natural catastrophes improved in both the Insurance and Reinsurance segments due to lower large property risk losses, as well as business mix changes and other underwriting improvements.

Current year net losses incurred increased by $778.6 million in 2011 as compared to 2010. This was mainly as a result of the current year loss ratio excluding prior year development increasing by 10.7 loss percentage points due to higher losses from natural catastrophes as compared to 2010, but also from the following: (i) the Insurance segment in 2011 experienced higher large loss activity in the energy, property and marine businesses, as compared to 2010; and (ii) the Reinsurance segment in 2011 experienced higher levels of large loss events in U.S. property, including a deterioration in the performance of a large U.S. agricultural program, higher attritional losses as well as business mix changes, as compared to 2010.

See the Income Statement Analysis at Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for further information regarding the current year loss ratios for each of the years indicated within each of our operating segments.

Prior year net losses incurred

The following tables present the development of our gross and net losses and loss expense reserves. The tables also show the estimated reserves at the beginning of each fiscal year and the favorable or adverse development (prior year development) of those reserves during such fiscal year.

Gross *(U.S. dollars in thousands)*	**2012**	**2011**	**2010**
Unpaid losses and loss expenses at January 1	$ 20,613,901	$ 20,531,607	$ 20,823,524
Gross (favorable) adverse development of those reserves during the year	(413,764)	(273,444)	(314,809)
Unpaid losses and loss expenses reserves re-estimated at December 31	$ 20,200,137	$ 20,258,163	$ 20,508,715

Net *(U.S. dollars in thousands)*			
Unpaid losses and loss expenses at January 1	$ 16,983,973	$ 16,882,317	$ 17,266,133
Net (favorable) adverse development of those reserves during the year	(315,895)	(284,867)	(372,862)
Unpaid losses and loss expenses reserves re-estimated at December 31	$ 16,668,078	$ 16,597,450	$ 16,893,271

As different reinsurance programs cover different underwriting years, contracts and lines of business, net and gross loss experience do not develop proportionately. In 2012, gross prior year favorable development exceeded net prior year favorable development in the Insurance segment due primarily to a significant reduction in a single large event in the International energy book that was heavily ceded. In 2011, gross prior year favorable development was in line with net prior year favorable development in total. However, during 2011, the Insurance segment experienced favorable net prior year development of $76.5 million compared to adverse gross prior year development of $23.1 million. The difference between net and gross development was driven primarily by adverse development related to large excess casualty claims associated with the Deepwater Horizon event in the 2010 accident year totaling $135.6 million on a gross basis, while the net impact was $33.4 million due to the offsetting impact of reinsurance protections. In addition, $150.0 million gross and $65.0 million net excess casualty IBNR reserves were reallocated to the 2010 accident year in respect of Deepwater Horizon exposures. These IBNR movements were entirely offset by reserve reductions in older accident years. This activity largely explains the difference between the gross and net prior year development for the Insurance segment in 2011 as well as the overall strengthening of the 2010 accident year reflected in the loss reserve development tables shown on the previous pages. During 2010, net prior year favorable development exceeded gross prior year favorable development due primarily to the Insurance segment from a single large claim in excess casualty that was heavily ceded.

The following table presents the gross and net (favorable) adverse prior year loss development of our loss and loss expense reserves by operating segment for each of the years indicated:

Gross: *(U.S. dollars in thousands)*	**2012**	**2011**	**2010**
Insurance	(247,232)	23,125	(31,387)
Reinsurance	(166,532)	(296,569)	(283,422)

Total	$	(413,764)	$	(273,444)	$	(314,809)

Net:						
Insurance	$	(140,067)	$	(76,516)	$	(127,411)
Reinsurance		(175,828)		(208,351)		(245,451)
Total	$	(315,895)	$	(284,867)	$	(372,862)

We had net favorable prior year reserve development in property and casualty operations of $315.9 million, $284.9 million and $372.9 million for the years ended December 31, 2012, 2011 and 2010, respectively. See the Income Statement Analysis at Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 10, Losses and Loss Expenses, to the Consolidated Financial Statements included herein, for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of our operating segments.

Net loss reserves (disposed) acquired

We did not dispose of or acquire net loss reserves in the years ended December 31, 2012, 2011 and 2010.

Exchange rate effects

Exchange rate effects on net loss reserves in each of the three years ended December 31, 2012, 2011 and 2010 related to our global operations primarily where reporting units have a functional currency that is not the U.S. dollar. In 2012, the U.S. dollar was weaker against the major currencies to which we are exposed, including the U.K. sterling, the Euro and the Swiss franc. In 2011, the U.S. dollar was stronger against U.K. sterling, the Euro, the Brazilian real and the Swiss franc, which more than offset losses that were driven by a stronger Australian dollar. In 2010, the U.S. dollar was stronger against the Euro, while weaker against the Swiss franc, Canadian dollar and Brazilian real. These movements in the U.S. dollar gave rise to translation and revaluation exchange movements related to carried loss reserve balances of $156.2 million, $(130.5) million and $(125.1) million in the years ended December 31, 2012, 2011 and 2010, respectively.

Net paid losses

Total net paid losses were $3.8 billion, $3.8 billion and $3.5 billion in 2012, 2011 and 2010, respectively. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for further information.

Other loss related information

Our net incurred losses and loss expenses include actual and estimates of potential non-recoveries from reinsurers. At December 31, 2012 and 2011, the reserve for potential non-recoveries from reinsurers was $107.9 million and $99.2 million, respectively. For further information, see Item 8, Note 9, Reinsurance, to the Consolidated Financial Statements included herein.

Except for certain workers compensation (including long term disability) liabilities and certain U.K. motor liability claims, we do not discount our unpaid losses and loss expenses.

We utilize tabular reserving for workers compensation (including long-term disability) unpaid losses that are considered fixed and determinable, and discount such losses using an interest rate of 5% in 2012 and 2011. The interest rate approximates the average yield to maturity on specific fixed income investments that support these liabilities. The tabular reserving methodology results in applying uniform and consistent criteria for establishing expected future indemnity and medical payments (including an explicit factor for medical inflation) and the use of mortality tables to determine expected payment periods. Tabular unpaid losses and loss expenses, net of reinsurance, at December 31, 2012 and 2011 on an undiscounted basis were $645.2 million and $612.9 million, respectively. The related discounted unpaid losses and loss expenses were $343.0 million and $290.3 million at December 31, 2012 and 2011, respectively.

The Company records specific reserve allowance for Periodical Payment Orders (PPO) in the U.K. motor liabilities. This allowance includes the unpaid losses for claims already settled and notified as PPO at December 31, 2012, as well as the unpaid losses for claims to be settled in the future. The future care element of the unpaid losses were discounted using an interest rate of 1.5% at December 31, 2012 reduced from 2% at December 31, 2011 to reflect the increased reserve and the yields obtained on the additional purchase of assets. Unpaid losses and loss expenses, net of reinsurance, at December 31, 2012 and 2011 on an undiscounted basis were $240.0 million and $52.8 million, respectively. After discounting of the future care element the unpaid losses and loss expenses were $148.6 million and $29.6 million at December 31, 2012 and 2011, respectively. The increase in net undiscounted unpaid losses and loss expenses between December 31, 2011 and December 31, 2012 is explained in part by the identification of a proportion of the overall UK motor reserves that will settle as Periodical Payment claims in the future. This is in

addition to a revision of the assumptions underlying the PPO reserve calculation and the worse than expected settlement of claims as PPOs during 2012.

Investments

Investment structure and strategy

Our investment operations are managed centrally by our Investment Group. The Risk and Finance Committee (the RFC) of the Board of Directors of XL-Ireland approves overall investment policy and guidelines, and reviews the implementation of the investment strategies on a regular basis.

Strategic Asset Allocation

The investment strategy for the investment portfolio is based on the strategic asset allocation (SAA) process, which establishes a benchmark for the aggregate investment portfolios supporting P&C investment operations and a separate benchmark for the aggregate investment portfolio supporting Life operations. These two benchmarks (SAA Benchmarks) are constructed to maximize company value subject to risk tolerance of management and various constraints, e.g., liability profile, local regulatory requirements, business needs, collateral management and insurance regulation. This process involves an integrated and stochastic model that includes our financial condition, reserve volatility and loss payout patterns, premium expense and loss ratio projections and correlations among asset, liabilities and economic variables.

As part of the implementation of our SAA Benchmarks, we employ a comprehensive framework of investment decision authorities (Authorities Framework). The objective of the Authorities Framework is to ensure that the risk profile of our investment portfolio is consistent with management s risk tolerance as reflected in the SAA Benchmarks. The Authorities Framework controls active or tactical deviations from the SAA Benchmarks. As the magnitude of these deviations increases or the resulting impact on the risk profile of the investment portfolio reaches certain predetermined thresholds, additional levels of authority and approval are required, up to and including the RFC.

The RFC reviews and approves the SAA Benchmarks for P&C and Life operations and the Authorities Framework as part of the investment policy. Management approves further detailed investment authorities which integrate the Authorities Framework into our risk governance processes. We have an ongoing process that focuses on optimizing the composition of the P&C and Life portfolios relative to the SAA Benchmarks. See Investment Portfolio Structure for more details.

Investment Portfolio Structure

Our investment portfolio consists of fixed income securities, equities, alternative investments, private investments, derivatives and other investments and cash. These securities and investments are denominated in U.S. dollar, U.K. sterling, Euro, Swiss franc, Canadian dollar and other foreign currencies.

Our direct use of investment derivatives includes futures, forwards, swaps and options that derive their value from underlying assets, indices, reference rates or a combination of these factors. Our current investment policy allows derivatives to be used in the investment portfolio to reduce risk and enhance portfolio efficiency. Derivatives may not be used if they materially increase our investment risk.

At December 31, 2012 and 2011, total investments, cash and cash equivalents, accrued investment income, and net receivable (payable) for investments sold (purchased), were $36.9 billion and $35.9 billion, respectively.

Functionally, our investment portfolio is divided into two principal components:

1) *P&C investment portfolio:* The larger component is the P&C investment portfolio and its principal objective is to support our insurance and reinsurance operations, the liabilities of which have some uncertainty as to the timing and/or amount. In addition, a smaller portion of the P&C investment portfolio supports corporate operations as well as

run-off financial lines business, in which the liabilities have a greater level of certainty and much longer durations than typical P&C business.

The investment strategy for the P&C investment portfolio is based on the SAA process with a constrained total return mandate. The primary performance objective is for the total return of the P&C portfolio to meet or exceed the return of the SAA Benchmark with realized loss constraints. The second performance objective is capital preservation through managing the risk profile of the investment portfolio within management s risk tolerance. The third performance objective is achieving the budget for net investment income.

2) *Life operations investment portfolio:* The second component of the investment portfolio is the Life operations investment portfolio. The principal objective of the Life operations investment portfolio is to support our Life operations, which are now in run-off. The largest portion of the Life operations investment portfolio supports the policy benefit reserves associated with asset annuity transactions, with limited uncertainty as to the timing or amount of the liability cash flows. A smaller portion of the Life operations investment portfolio supports life annuity liabilities that were assumed without portfolio asset transfer.

As discussed above, the investment strategy for the Life operations investment portfolio is based on the SAA process. The Life operations investment portfolio SAA process incorporates an additional overlay of the regulatory capital model and a more extensive focus on asset-liability management, which is possible due to the lower volatility of life liabilities relative to P&C liabilities.

The primary performance objective for the investments supporting the asset annuity transactions is to achieve a steady credit-adjusted book yield of the Life operations investment portfolio in order to maximize the embedded value and minimize statutory capital needs (owing to unique technical requirements of the statutory capital model). For the investments supporting the other portions of the Life operations investment portfolio, which do not have this unique capital model, the performance objective is for the constrained total return to at least match the total return of the benchmark, similar to that used in the P&C investment portfolio.

Implementation of investment strategy

Although our management within the Investment Group is responsible for implementation of the investment strategy, the day-to-day management of our investment portfolio is outsourced to investment management service providers in accordance with detailed investment guidelines provided and monitored by us. This approach gives us access to top investment talent with specialized skills across a broad range of investment products and provides flexibility to actively manage the structure of the portfolio as dictated by our business needs. Investment management service providers are selected directly on the basis of various criteria including investment style, track record, performance, risk management capabilities, internal controls, operational risk management and diversification implications. The vast majority of our investment portfolio is managed by large, well-established asset management institutions, while a small portion of the portfolio is managed by asset management specialist firms or boutiques. Each investment management service provider may manage one or more portfolios, each of which is generally governed by a detailed set of investment guidelines, including overall objectives, risk limits (where appropriate) and diversification requirements that fall within our overall investment policies and guidelines, including but not limited to exposures to eligible securities, prohibited investments/transactions, credit quality and general concentration limits. The Investment Group has a surveillance program to manage the aggregation of individual manager portfolios relative to the SAA Benchmarks.

Investment performance

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Investment Performance, for discussion of our investment performance.

Investment portfolio credit ratings, duration and maturity profile

It is our policy to operate the combined P&C and Life (aggregate) fixed income portfolio with a minimum weighted average credit rating of Aa3/AA-. See Item 1A, Risk Factors, for discussion on ratings downgrades. The aggregate credit rating is determined based on the weighted average rating of securities, where the average credit rating, where available, from Standard & Poor s (S&P), Moody s Investors Service (Moody s) and Fitch Ratings (Fitch) is allocat each security. The weighted average credit rating of the aggregate fixed income portfolio was Aa2/AA at December 31, 2012 and 2011. U.S. agencies and Agency RMBS paper, whether with implicit or explicit government support, reflect the credit quality rating of the U.S. government for the purpose of these calculations.

We did not have an aggregate direct investment in a single corporate issuer in excess of 5% of shareholders equity at December 31, 2012 or 2011. Corporate issuers represent our direct exposure to fixed maturities and short-term investments of the parent issuer and its subsidiaries. These exposures exclude

asset and mortgage-backed securities that were issued, sponsored or serviced by the parent and government-guaranteed issues, but does include covered bonds. The Company invests in covered bonds issued by financial institutions (Covered Bonds). Covered Bonds are senior secured debt instruments issued by financial institutions and backed by over-collateralized pools of public sector or mortgage loans.

The overall duration and currency denomination of the aggregate fixed income portfolio is managed relative to the respective SAA Benchmarks for the P&C and Life operations investment portfolios, both of which incorporate matching currency and duration within a range relative to liabilities. Duration measures bond price volatility and is an indicator of the sensitivity of the price of a bond (or a portfolio of bonds) to changes in interest rates, assuming a parallel change in all global yield curves reflecting the percentage change in price for a 100 basis point change in yield. Management believes that the duration of the aggregate fixed income portfolio is the best single measure of interest rate risk for the aggregate fixed income portfolio.

The maturity profile of the aggregate fixed income portfolio is a function of the maturity profile of estimated loss payments from our liabilities, our capital and expected operating cash flows and, to a lesser extent, the maturity profile of common fixed income benchmarks. For further information on the maturity profile of the fixed income portfolio, see Item 8, Note 5, Investments, to the Consolidated Financial Statements included herein.

Enterprise Risk Management

Risk Management Framework

We face strategic and operational risks related to, among others: underwriting activities, financial reporting, changing macroeconomic conditions, investment risks, reserving estimates, changes in laws or regulations, information systems, business interruption and fraud. Our global P&C business, Life operations (which is in run-off) and investment portfolios each have their own set of risks (see Item 1A, Risk Factors, for a discussion of such risks). From time to time, these risks may exhibit greater levels of correlation than might be expected over the longer term due to the presence of, to a greater or lesser degree, some common internal or external risk drivers embedded in our businesses that may manifest themselves simultaneously. An enterprise view of risk is required to identify and manage the consequences of these common risks and risk drivers on our profitability, capital strength and liquidity.

Our enterprise risk management (ERM) initiatives are led by the Chief Enterprise Risk Officer (CERO), who is a member of our leadership team, and who reports to our Chief Executive Officer. The CERO also acts as a liaison between our Enterprise Risk Committee (ERC - see below) and the XL-Ireland Board (or its committees), with respect to risk matters. All of our employees are expected to assist in the appropriate and timely identification and management of risks and to enhance the quality and effectiveness of ERM.

Our ERM framework is designed to allow us to identify and understand material risk concentrations, including concentrations that have unattractive risk/reward dynamics so that prompt, appropriate, corrective or mitigating actions can be taken. To do this, we have risk management committees and processes to serve as points of managerial dialogue and convergence across our businesses and functional areas, to create risk aggregation methodologies and to develop specific risk appetites to coordinate the identification, vetting and discussion of risk topics and metrics. As part of our ERM activities, we apply a suite of stress tests, tools, risk indicators, metrics and reporting processes that examine the consequences of low probability/high severity events (including those related to emerging risks) in order to take mitigating actions where required.

Risk Governance

Risk governance relates to the processes by which oversight and decision-making authorities with respect to risks are granted to individuals within the enterprise. Our governance framework establishes accountabilities for tasks and outcomes as well as escalation criteria. Governance processes are designed to ensure that transactions and activities,

individually and in the aggregate, are carried out in accordance with our risk policies, philosophies, appetites, limits and risk concentrations, and in a manner consistent with expectations of excellence of integrity, accountability and client service.

The RFC of the XL-Ireland Board oversees ERM matters. With respect to the responsibilities relating to ERM, the RFC:

- Oversees ERM activities, including the risk management framework employed by management. In light of the overall risk management framework, the RFC (i) reviews the methodology for establishing our overall risk capacity; (ii) reviews the policies for the establishment of risk limit frameworks, and adherence to such limits; and (iii) reviews and approves enterprise risk limits.

- Oversees our compliance with any significant enterprise risk limits, authorities and policies. The RFC evaluates what actions to take with respect to

such enterprise limits, authorities and policies, and approves any exceptions thereto from time to time as necessary.

Reviews our overall risk profile and monitors key risks across our organization as a whole, which may involve coordination with other committees of the Board from time to time as appropriate.

Reviews our process controls over model use and development with respect to model risk and model effectiveness, accuracy, and propriety.

Monitors our risk management performance and obtains reasonable assurance from management

that our risk management policies are effective and are being adhered to.

The review of our overall risk appetites and the evaluation of the risk impact of any material strategic decision being contemplated, including consideration of whether such strategic decision is within the risk profile established by us, is conducted by the full Board. Risk appetites, as referred to above, are broad statements used to guide our risk and reward preferences over time, all consistent with, among other factors, business prudence, market opportunities, the underwriting pricing cycle and investment climate. Risk appetites are regularly monitored and can change over time in light of the above. See Risk Appetite Management below.

Management oversight of ERM is performed, in part, via a centralized management ERC, which is chaired by the CERO. The ERC is comprised of senior management from our businesses and functions and is charged with developing and monitoring enterprise risk policies, risk appetites, risk limits (and compliance with such limits) and risk aggregations, and identifying key emerging risks and ways to mitigate such risks.

In addition to the ERC, we have established a framework of separate yet complementary ERM subcommittees, each focusing on particular aspects of ERM. These subcommittees include:

Economic Capital Model Subcommittee: This subcommittee oversees the development of economic capital models that support ERM activities, and helps set priorities and manage resources related to such models. It reviews assumptions and related methodologies used within our economic capital models, including assessments of model validation, model control

and model risk.

Liability Subcommittee: This subcommittee supports and assists the ERC s identification, measurement, management, monitoring and reporting of key underwriting liability and emerging risks.

Asset Risk Subcommittee: This subcommittee assists the ERC in its responsibilities in relation to governance and oversight of asset-related risks across the Company, including the investment portfolio. Among its activities are (a) involvement in policy decisions on modeling and quantification of risk measurements; and (b) providing an interpretation and assessment of asset-related risks, with a particular focus

on market-related risks. Further, the subcommittee is responsible for coordinating on a regular basis with the Credit Subcommittee of the ERC on asset-related credit risks.

Credit Subcommittee: This subcommittee develops and implements the metrics and supporting framework for allocation of credit risk capacity across major business units and functions, including the amount and types of credit exposure.

Operational Risk Subcommittee: This subcommittee supports the ERC s identification, measurement, management and oversight of key operational risks through its oversight of key operational

risk
management
processes and
through its
review of
related
operational risk
indicators,
trends and
metrics.

In addition to the above, risk management subcommittees within each of our businesses function to ensure that risk is managed in accordance with the risk limits, guidelines and tolerances that we have allocated to them.

Risk Appetite Management

Our risk appetite framework guides our strategies relating to, among other things, capital preservation, earnings volatility, capital at risk, operational loss, liquidity standards, claims paying rating and capital structure. This framework also addresses our tolerance to risks from material individual events (e.g., natural or man- made catastrophes such as terrorism), our investment portfolio and realistic disaster scenarios that cross multiple lines of business (and risks related to some or all of the above that may occur concurrently).

In relation to event risk management, we establish net underwriting limits for individual large events as follows:

1. We impose limits for each natural catastrophe peril region at a 1% tail value at risk (TVaR) probability. This statistic indicates the average amount of net loss expected to be incurred given that a loss above the 1% exceedance probability level has occurred.

2. For each event type other than natural catastrophes, we impose limits at a 1% exceedance probability. If we were to deploy the full limit, for any given

event type, there would be a 1% probability that an event would occur during the next year that would result in a net underwriting loss in excess of the limit.

3. We also impose limits for certain other event types at a 0.4% exceedance probability as described in further detail below. If we were to deploy the full limit, for any such given event type, there would be a 0.4% probability that an event would occur during the next year that would result in a net underwriting loss in excess of the limit.

For planning purposes and to calibrate risk tolerances for business to be written from September 30, 2012 through September 30, 2013, we set our underwriting limits as a percent of September 30, 2012 Tangible Shareholders Equity (hereafter, Tangible Shareholders Equity). Tangible Shareholders Equity is defined as Total Shareholders Equity less Goodwill and Other Intangible Assets. These limits may be recalibrated, from time to time, to reflect material changes in Total Shareholders Equity that may occur after September 30, 2012, at the discretion of management and as overseen by the Board.

Tier I event types (Tier 1 Events), which include natural catastrophes, terrorism and other realistic disaster scenarios, and Tier 2 event types (Tier 2 Events), which include country risk, longevity risk and pandemic risk, are internal risk classifications for the purposes of defining our risk tolerances. In determining Tier 1 and Tier 2 Events we consider such factors as:

- Anticipated risk adjusted returns;
- Strategic risk preferences;
- Relativity to peers;
- Shareholder expectations;
- Robustness of exposure assessment methodology; and
- Projected enterprise loss potential.

Per event 1% TVaR underwriting limits for North Atlantic Windstorm are set at a level not to exceed approximately 22% of Tangible Shareholders Equity. Per event 1% TVaR underwriting limits for North American Earthquake are set at a level not to exceed approximately 20% of Tangible Shareholders Equity. Per event 1% TVaR underwriting limits for all other natural catastrophe peril regions are set below the per event 1% TVaR limits described above.

Per event 1% exceedance probability underwriting limits for terrorism and other realistic disaster scenarios are set at a level not to exceed approximately 15% of Tangible Shareholders Equity.

Per event 1% exceedance probability underwriting limits for Tier 2 Events are set at a level not to exceed 7.5% of Tangible Shareholders Equity.

Per event 0.4% exceedance probability underwriting limits for certain Tier 2 Events are set at a level not to exceed 10% of Tangible Shareholders Equity. The 0.4% exceedance probability limit is used for Tier 2 Events rather than a TVaR measure due to the difficulty in estimating the full distribution of outcomes in the extreme tail of the distribution for these risk types as required for the TVaR measure.

In all instances, the above referenced underwriting limits reflect pre-tax losses net of reinsurance and include inwards and outwards reinstatement premiums related to the specific events being measured. The limits do not contemplate underwriting profits expected to be generated in the absence of catastrophic loss activity.

In setting underwriting limits, we also consider such factors as:

- Correlation of underwriting risk with other risks (e.g., asset/investment risk, operational risk, etc.);
- Model risk and robustness of data;
- Geographical concentrations;
- Exposures at lower return periods;
- Expected payback period associated with losses;
- Projected share of industry loss; and
- Annual aggregate losses for natural catastrophes at various return periods including a 1% exceedance probability and a 1% TVaR level on both a peril

- region basis and a portfolio basis.

Loss exposure estimates for all event risks are derived from a combination of commercially available and internally developed models together with the judgment of management, as overseen by the XL-Ireland Board. Actual incurred losses may vary materially from our estimates. Factors that can cause a deviation between estimated and actualized loss potential include:

- Inaccurate assumption of event frequency and severity;
- Inaccurate or incomplete data;
- Changing climate conditions that may add to the unpredictability of frequency and severity of natural catastrophes in certain parts of the world and create additional uncertainty as to future trends and exposures;
- Future possible increases in property values and the effects of inflation that may increase the severity of catastrophic events to levels above the modeled levels;
- Natural catastrophe models that incorporate and are critically dependent on meteorological,

seismological and other earth science assumptions and related statistical relationships that may not be representative of prevailing conditions and risks, and may therefore misstate how particular events actually materialize, causing a material deviation between forecasted and actual damages associated with such events; and

A change in the judicial climate.

For the above and other reasons, the incidence, timing and severity of catastrophes and other event types are inherently unpredictable and it is difficult to estimate the amount of loss any given occurrence will generate. As a consequence, there is material uncertainty around our ability to measure exposures associated with individual events and combinations of events. This uncertainty could cause actual exposures and losses to deviate from those amounts estimated, which in turn can create a material adverse effect on our financial condition and results of operations and may result in substantial liquidation of investments, possibly at a loss, and outflows of cash as losses are paid. For this reason, we carry capital in addition to that required by the specific limits described even if it is in excess of rating agency and regulatory required capital.

For a further discussion on risk appetite management see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Other Key Focuses of Management.

Impact of ERM Processes

We believe that our ERM processes improve the quality and timeliness of strategic decisions, enhance the integration of strategic initiatives with the risks related to such initiatives and act as catalysts to improve risk awareness and informed action by us. We believe that the integration of ERM with existing business processes and controls optimizes the risk/reward characteristics of business strategies, enhances our overall risk management culture, and is central to our capital allocation process.

In addition, our ERM processes complement our overall internal control framework by helping to manage the complexity that is inherent within an organization of our size and with the variety of our businesses, investment activities and geographical reach. However, internal controls and ERM can provide only reasonable, not absolute, assurance that control objectives will be met. As a result, the possibility of material financial loss remains in spite of our ERM activities. An investor should carefully consider the risks and all information set forth in this report including the discussion included in Item 1A, Risk Factors, Item 7A, Quantitative and Qualitative Disclosure About Market Risk, and Item 8, Financial Statements and Supplementary Data.

Regulation

Our operating subsidiaries are subject to regulation and supervision in each of the jurisdictions in which they are domiciled and licensed to conduct business. Generally, regulatory authorities can have broad supervisory and administrative powers over such matters as licenses, fitness of management, standards of solvency, material transactions between affiliates, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of financial statements, reserves for unpaid losses and loss adjustment expenses, claims handling, reinsurance, minimum capital and surplus requirements and/or risk based capital standards, dividends and other distributions to shareholders, periodic examinations and annual and other report filings or notifications. See Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements included herein. In general, such regulation is for the protection of policyholders rather than shareholders. We cannot predict the potential effect that any new regulations would have on our operating subsidiaries or on our business, results of operations, cash flows or financial condition. See Risk Factors – The regulatory regimes under which we operate, and potential changes thereto, could have a material adverse effect on our business. A summary of certain regulatory requirements in the key jurisdictions in which we operate follows.

In addition, XL-Ireland, our ultimate holding company, is domiciled in Ireland. Although XL-Ireland is not an Irish regulated operating entity, the Central Bank of Ireland, or CBI, has informed us that it will be our group supervisor under Solvency II. Adopted by the European Parliament in April 2009, Solvency II is an E.U. directive covering the capital adequacy and risk management of, and regulatory reporting for, European-based (re)insurers. Several steps must be taken by the European Commission, the European Parliament, the Council of Ministers and the European Insurance and Occupational Pensions Authority (EIOPA) to implement Solvency II. The final date of implementation and key elements of the framework remain under discussion, but it is widely accepted that the envisaged implementation date of January 1, 2014 will not be met. In October 2012, the European Parliament rescheduled the plenary vote of the Omnibus II Directive from November 2012 to March 2013. The Omnibus II directive sets the date of entry into force of the Solvency II regime and amends the Solvency II framework directive on capital requirements for insurance companies. Following adoption, there are multiple rounds of consultation and publication prior to implementation.

As an Irish public company, XL-Ireland is subject to reporting requirements and certain restrictions under Irish company law. See Management s Discussion & Analysis of Financial Condition Holding Company Liquidity and Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements included herein.

Ireland

Our Irish regulated operating subsidiary, XL Re Europe public limited company, is subject to the regulatory framework established by the CBI. It is required to, among other matters:

- maintain an adequate solvency margin and guarantee fund;

- submit quarterly and annual regulatory returns as well as ad hoc reporting of certain material transactions; and

- obtain regulatory pre-approval of certain transactions, such as payment of dividends or acquisitions and disposals in the ownership/voting rights of (re)insurance companies.

The CBI has minimum competency and fitness and probity codes that seek to ensure that regulated entities are run by those with appropriate professional qualifications or experience within the CBI s view, with regulatory pre-approval required for certain key roles. The CBI s code of corporate governance includes prescriptive rules regarding board role and composition, establishment and operation of board sub-committees and requirements around the approval of risk appetites and the monitoring and reporting of risks. In addition, the CBI has broad supervisory and administrative powers over capital and surplus requirements and the declaration of and payment of dividends or other distributions. Our Irish operating subsidiary is required to seek prior approval from the CBI to reduce its share capital or to pay dividends.

United Kingdom

Our U.K. regulated operating subsidiaries are regulated by the Financial Services Authority (FSA). The FSA s Handbook of Rules and Guidance (the FSA Rules) covers all aspects of regulation including capital adequacy, financial and non-financial reporting, the payment of dividends and certain other activities of U.K. regulated firms. Our Lloyd s managing agency, its managed syndicates and its associated corporate capital vehicles are subject to additional Lloyd s requirements. The FSA s Approved Persons regime also subjects certain of our employees and directors to FSA regulation regarding their fitness.

In 2010, the U.K. government released plans to abolish the FSA and separate its responsibilities between a number of new agencies and the Bank of England. This is expected to occur in the Spring of 2013. In 2013, the FSA will be replaced by two new regulatory bodies: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Both the PRA and FCA will have regulatory oversight of our U.K. regulated operating subsidiaries.

Other European Union

Our network of offices in the European Union consists mainly of branches of Irish and U.K. companies and these offices are principally regulated under European directives from their home states of Ireland and the U.K., respectively, rather than by each individual jurisdiction.

Bermuda Operations

The Insurance Act 1978 of Bermuda and related rules and regulations, as amended (the Bermuda Act), regulates our Bermuda (re)insurance operating subsidiaries, which must be registered as (re)insurers by the Bermuda Monetary Authority (the BMA). The Bermuda Act imposes on Bermuda (re)insurance companies, solvency and liquidity standards, certain restrictions on the declaration and payment of dividends and distributions, certain restrictions on the reduction of statutory capital, auditing and reporting requirements, and grants the BMA powers to supervise and, in certain circumstances, to investigate and intervene in the affairs of (re)insurance companies.

Certain of our Bermuda regulated (re)insurance companies are required to prepare and file annual audited GAAP or International Financial Reporting Standards financial statements, as well as annual statutory financial returns, annual capital and solvency returns and quarterly financial returns.

Our Bermuda regulated general business (re)insurers are required to maintain available statutory capital and surplus at a level equal to or in excess of their enhanced capital requirement (ECR). The applicable ECR is established by reference to either the Bermuda Solvency Capital Requirement (BSCR), which employs a standard mathematical model that can relate more accurately the risks taken on by (re) insurers to the capital that is dedicated to their business, or a BMA-approved internal capital model. The BMA has also established a target capital level (TCL) for each (re)insurer equal to 120% of its ECR. While (re)insurers are not required to maintain their statutory capital and surplus at this level, the TCL acts as an early warning tool for the BMA and failure to maintain statutory capital at least equal to TCL will likely result in increased BMA regulatory oversight. Our Bermuda regulated (re)insurers use the BSCR model to calculate their solvency requirements.

Under the Bermuda Companies Act 1981, as amended, a Bermuda company may not declare or pay a dividend or make a distribution out of contributed surplus if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the company s assets would thereby be less than its liabilities. Under the Bermuda Act, a Class 4 (re)insurer is prohibited from declaring or paying any dividends of more than 25% of its total statutory capital and surplus unless it certifies to the BMA that it will continue to meet its minimum solvency margin and minimum liquidity ratio.

In addition, neither Class 4 (re)insurers nor certain long-term (re)insurers may reduce their total statutory capital by 15% or more unless they have received the prior approval from the BMA.

United States

In the United States, we are subject to extensive regulation in the jurisdictions in which we conduct our business. The state legislatures and/or state (re)insurance regulators consider or enact laws or regulations that may alter or increase the regulation of (re)insurance companies and (re)insurance holding companies. State laws and regulations that are adopted or amended may be more restrictive than current laws and regulations and may affect our operations, financial condition through lower revenue and/or higher costs of compliance and could adversely affect our results of operations and limit our growth. For example, regulators may choose to restrict the ability of subsidiaries to make payments to their parent companies, reject rate increases or increase the statutory capital requirements of our operating subsidiaries.

There are a number of proposals to amend state insurance laws and regulations in ways that could affect our insurance operating subsidiaries. The National Association of Insurance Commissioners (NAIC) has recently adopted or amended model laws on holding company regulation that would provide for supervision of insurers at the corporate group level. Although such changes are only beginning to be considered or adopted by individual state regulators, it can be expected that most state regulators will ultimately adopt them in some form. The various proposals to implement group supervision include uniform standards for insurer corporate governance, group-wide supervision of insurance holding companies, adjustments to risk-based capital calculations to account for group-wide risks and additional regulatory and disclosure requirements for insurance holding companies.

Additionally, the NAIC has undertaken the Solvency Modernization Initiative (SMI), which focuses on a review of insurance solvency regulations throughout the U.S. financial regulatory system and will lead to a set of long-term solvency modernization goals. SMI is broad in scope, but the NAIC has stated that its focus will include the U.S. solvency framework, group solvency issues, capital requirements, international accounting and regulatory standards, reinsurance and corporate governance.

Currently, our U.S. regulated operating subsidiaries are required to file detailed annual and, in most states, quarterly reports with state insurance regulators in each of the states in which they are licensed or accredited. In addition, these subsidiaries operations and accounts are subject to financial condition and market conduct examination at regular intervals by state regulators. In June of 2012, all three states in which the U.S. insurance and reinsurance subsidiaries are domiciled (New York, Delaware and North Dakota) issued reports on their examination of the financial condition of each of the subsidiaries for the five year period ended December 31, 2010. The reports concluded that all findings from the prior examination had been effectively addressed, and no new findings were reported.

Our U.S. regulated operating subsidiaries are subject to various state statutory and regulatory restrictions that limit the amount of dividends that may be paid from earned surplus without prior approval from regulatory authorities. These restrictions differ by state, but are generally based on a calculation of the lesser of 10% of statutory surplus or 100% of adjusted net investment income to the extent that it has not previously been distributed.

While the U.S. federal government currently does not directly regulate the insurance business in the U.S. (other than for flood, nuclear and reinsurance of losses from terrorism), federal legislation and administrative policies can affect

the insurance industry. In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was passed into law. Dodd-Frank requires the creation of a Federal Insurance Office within the Treasury Department that will be focused on national coordination of the insurance sector, systemic risk mitigation and international regulatory cooperation. Although the Federal

Insurance Office currently does not directly regulate the insurance industry, under Dodd-Frank it has the power to preempt state insurance regulations that are inconsistent with international agreements regarding insurance regulation, subject to certain exceptions. In addition, Dodd-Frank provides that the Federal Insurance Office must submit a report to Congress on improving U.S. insurance regulation, which must cover the feasibility of future federal regulation of the U.S. insurance industry.

Other International Operations

We have a number of regulated operating subsidiaries outside of the European Union, Bermuda and the United States. The degree of regulation in foreign jurisdictions can vary and licenses issued by foreign authorities are subject to modification or revocation for cause by such authorities. Our subsidiaries could be prevented, for cause, from conducting business in certain of the jurisdictions where they currently operate. While each country imposes licensing, solvency, auditing and financial reporting requirements, the type and extent of the requirements differ substantially. Key areas where country regulations may differ include: (i) the type of financial reports to be filed; (ii) a requirement to use local intermediaries; (iii) the amount of reinsurance permissible; (iv) the scope of any regulation of policy forms and rates; and (v) the type and frequency of regulatory examinations.

In addition to these requirements, our foreign operations are also regulated in various jurisdictions with respect to currency, amount and type of security deposits, amount and type of reserves, amount and type of local investment and limitations on the share of profits to be returned to policyholders on participating policies. A summary of certain regulatory requirements in Switzerland, Latin America and China follows.

Switzerland

Supervision of our Swiss regulated operating subsidiaries is carried out by the Federal Financial Market Supervisory Authority (FINMA). The supervisory regime currently comprises both Solvency I requirements and Solvency II type requirements (Swiss Solvency Test), the latter of which impose higher capital requirements. Furthermore, direct insurers and insurance branches operating in Switzerland have to comply with tied assets requirements. Reinsurance branches of foreign legal entities are exempt from supervision by FINMA and are supervised by the country in which they are domiciled.

The Swiss supervisory regime was considered in EIOPA s first wave of third country equivalence assessment for Solvency II. EIOPA advised that Switzerland meets the criteria set out in EIOPA s methodology for equivalence assessments for Article 172 (equivalence for reinsurance supervision) and Article 260 (equivalence for third country group supervision), with certain caveats. For Article 227 (Calculating group solvability), the Swiss regulatory regime was assessed as equivalent, with no caveats.

In September 2012, FINMA and EIOPA signed a Memorandum of Understanding (MoU) regarding cooperation in supervision, in particular for insurance groups with international activities in the European Economic Area and Switzerland. The MoU creates a formal basis for cooperation in the following areas: group supervision, assistance in the work of EEA and FINMA colleges of supervisors, action required in emergency situations, safeguarding financial stability by monitoring and assessing risks, interconnectedness and conducting stress tests. This MoU will not modify or supersede any laws or regulatory requirements in force and will not affect any arrangements under the MoU that have previously been signed between FINMA and other national supervisory authorities of the EEA.

Latin America

We have both insurance and reinsurance operations in the Latin America region, with local companies in Brazil and Mexico and representative offices in Argentina and Colombia. Other than the Colombia representative office, all the legal entities in the region are subsidiaries, and there are no branches. Where we do not have a legal entity, we act as a foreign reinsurer. Nearly all regulators in the Latin America region require foreign reinsurers to be registered or

licensed to accept reinsurance business.

The extent of regulation in the region varies significantly in the countries in which we conduct business. Typically, each country has regulations relating to solvency, auditing, internal controls and financial reporting, but the type and extent of the requirements differs substantially. Other regulations in the region that impact our operations but are not specific to insurance or reinsurance include those relating to

foreign currency exchange control, data protection legislation, anti-money laundering legislation and sanctions.

China

Our Chinese regulated operating subsidiary is regulated by the China Insurance Regulatory Commission (the CIRC) under the People s Republic of China Insurance Law. CIRC s regulatory regime includes requirements relating to licensing, capital, premium and liability, disclosure and periodic reporting and approval or filing of policy wordings and rates.

Employees

At December 31, 2012, we had 4,007 employees. At that date, 232 of our employees were represented by workers councils and 418 of our employees were subject to industry-wide collective bargaining agreements in several countries outside the United States.

Available Information

The public can read and copy any materials we file with the U.S. Securities and Exchange Commission (SEC) at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers, including us, that file electronically with the SEC. The address of the SEC s website is *http://www.sec.gov*.

Our website address is *http://www.xlgroup.com.* The information contained on our website is not incorporated by reference into this Annual Report on Form 10-K or any other of our documents filed with or furnished to the SEC.

We make available free of charge, including through our website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 (a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

We have adopted Corporate Governance Guidelines, written charters for each of the Audit Committee, the Management Development and Compensation Committee, the Nominating, Governance and External Affairs Committee and the Risk and Finance Committee, as well as a Code of Conduct and a related Compliance Program. Each of these documents is posted on our website at *http://www.xlgroup.com*, and each is available in print to any shareholder who requests it by writing to us at Investor Relations Department, XL Group plc, Harbor Point, 100 Washington Boulevard, Stamford, CT 06902, United States of America.

We intend to post on our website any amendment to, or waiver of, a provision of our Code of Conduct that applies to our Chief Executive Officer, Chief Financial Officer and Corporate Controller or persons performing similar functions and that relates to any element of the code of ethics definition set forth in Item 406 of Regulation S-K under the Securities Act of 1933, as amended.

We intend to use our website as a means of disclosing material non-public information and for complying with our disclosure obligations under Regulation FD. Such disclosures will be included on the website in the Investor Relations section. Accordingly, investors should monitor such portions of our website, in addition to following our press releases, SEC filings and public conference calls and webcasts.

ITEM 1A. RISK FACTORS

Any of the following risk factors could have a significant or material adverse effect on our business, financial condition, results of operations and/or liquidity, in addition to the other information contained in this report. Additional risks not presently known to us or that we currently deem immaterial may also impair our business, financial condition and results of operations.

The occurrence of disasters could adversely affect our financial condition, results of operations, cashflows and prospects.

We have substantial exposure to losses resulting from natural and man-made disasters and other catastrophic events. Catastrophes can be caused by various events, including hurricanes, earthquakes, floods, hailstorms, explosions, severe weather, fires, war and acts of terrorism. Changing climate conditions may add to the unpredictability and frequency of natural disasters in certain parts of the world and create additional uncertainty as to future trends and exposures. The incidence and severity of catastrophes are inherently unpredictable, and it is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss any given occurrence will generate.

The occurrence of claims from catastrophic events is likely to result in substantial volatility in our financial condition, results of operations and cash flows for the fiscal quarter or year in which a catastrophic event occurs, as well as subsequent fiscal periods, and could have a material adverse effect on our financial condition and results of operations and our ability to write new business. This risk is exacerbated due to accounting principles and rules that do not permit (re)insurers to reserve for such catastrophic events until they occur. We expect that future possible increases in the values and concentrations of insured property, the effects of inflation and changes in cyclical weather patterns may increase the severity of catastrophic events in the future. Although we attempt to manage our exposure to catastrophic events, a single catastrophic event could affect multiple geographic zones and lines of business and the frequency or severity of catastrophic events could exceed our estimates, in each case potentially having a material adverse effect on our financial condition, results of operations and cash flows. In addition, while we may, depending on market conditions, purchase catastrophe reinsurance and retrocessional protection, the occurrence of one or more major catastrophes in any given period could result in losses that exceed such reinsurance and retrocessional protection. This could have a material adverse effect on our financial condition and results of operations and may result in substantial liquidation of investments, possibly at a loss, and outflows of cash as losses are paid.

The failure of any of the underwriting risk management strategies that we employ could have a material adverse effect on our financial condition, results of operations and/or liquidity.

We seek to limit our loss exposure by, among other things, writing a number of our reinsurance or retrocession contracts on an excess of loss basis, adhering to maximum limitations on reinsurance written in defined geographical zones, limiting program size for each client and prudently underwriting each program written. In addition, in the case of proportional treaties, we generally seek to use per occurrence limitations or loss ratio caps to limit the impact of losses from any one event. We cannot be sure that all of these loss limitation methods will have the precise risk management impact intended. For instance, although we also seek to limit our loss exposure by geographic diversification, geographic zone limitations involve significant underwriting judgments, including the determination of the area of the zones and the inclusion of a particular policy within a particular zone s limits. Underwriting involves the exercise of considerable judgment and the making of important assumptions about matters that are inherently unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance. The failure of any of the underwriting risk management strategies that we employ could have a material adverse effect on our financial condition, results of operations and cash flows. Also, we cannot provide assurance that various provisions of our policies, such as limitations or exclusions from coverage or choice of forum,

will be enforceable in the manner that we intend and disputes relating to coverage and choice of legal forum may arise, which could materially adversely affect our financial condition and results of operations.

The insurance and reinsurance industries are historically cyclical and we may experience periods with excess underwriting capacity and unfavorable premium rates.

The insurance and reinsurance industries have historically been cyclical, characterized by periods of intense price competition due to excess underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. An increase in premium levels is often followed by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Either of these factors could lead to a significant reduction in premium rates, less favorable policy terms and conditions and fewer submissions for our underwriting services. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the insurance and reinsurance industries significantly.

A downgrade or potential downgrade in our financial strength and credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations and/or cash flows.

As our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies, a downgrade by any of these institutions could cause our competitive position in the insurance and reinsurance industry to suffer and make it more difficult for us to market our products.

A downgrade below A- of our principal insurance and reinsurance subsidiaries by either Standard & Poor s (S&P) or A.M. Best Company (A.M. Best), which is two notches below the current S&P and A.M. Best financial strength ratings of A (Positive) and A (Stable), respectively, for our principal insurance and reinsurance subsidiaries, may trigger termination provisions in a significant amount of our assumed reinsurance agreements and may potentially require us to return unearned premium to cedants. Whether a client would exercise its termination rights after such a downgrade would likely depend on, among other things, the reasons for the downgrade, the extent of the downgrade, prevailing market conditions, the degree of unexpired coverage, and the pricing and availability of replacement reinsurance coverage. Based on premium value, approximately 70% of our in force reinsurance contracts at January 1, 2013 contained provisions allowing clients to terminate those contracts upon a decline in our ratings to below A-. In the event of such a downgrade, we cannot predict whether or how many of our clients would actually exercise such termination rights or the extent to which any such terminations would have a material adverse effect on our financial condition, results of operations, cash flows or future prospects or the market price for our securities. A downgrade could also result in both a substantial loss of business for us as ceding companies and brokers that place such business may move to other insurers and reinsurers with higher ratings and the loss of key employees. In addition, due to collateral posting requirements under our letter of credit and revolving credit facility agreements, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities (see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources under Part II, Item 7 of this report). Specifically, a downgrade below A- by A.M. Best would constitute an event of default under the Company s three largest credit facilities and may trigger such collateral requirements. In certain limited instances, such downgrades may require us to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties.

In addition to the financial strength ratings of our principal insurance and reinsurance subsidiaries, various rating agencies also publish credit ratings for XL-Cayman. Credit ratings are indicators of a debt issuer s ability to meet the terms of debt obligations in a timely manner, are part of our overall funding profile and affect our ability to access certain types of liquidity. Downgrades in our credit ratings could have a material adverse effect on our financial condition and results of operations and cash flows in a number of ways, including adversely limiting our access to capital markets, potentially increasing the cost of debt or requiring us to post collateral.

Downgrading of the United States credit rating could have a material adverse effect on our business, financial condition and results of operations.

Standard & Poor s Ratings Services lowered its long-term sovereign credit rating on the United States from AAA to AA+ in August 2011. In addition, Standard & Poor s Rating Services and Moody s

Investor Services maintain a negative outlook on U.S. debt, and both Fitch Ratings and Moody s Investors Services have warned that they may downgrade the U.S. government s sovereign credit rating if future budget negotiations to raise the debt ceiling fail, or if steps are not taken to decrease the U.S. s debt load. Because of the unprecedented nature of negative credit rating actions with respect to U.S. government obligations, the impact of a further downgrade to the U.S. government s sovereign credit rating or any other further rating actions by any rating agency is inherently unpredictable. Such actions could have material adverse impacts on financial markets and economic conditions in the United States and throughout the world. In turn, this could have a material adverse effect on our business, financial condition and results of operations, including with respect to assets in our investment portfolio, as well as assets in trusts or other collateral arrangements posted by or to us. In addition, further downgrades of the United States credit rating could create broader financial turmoil and uncertainty, and could negatively impact the average credit rating quality of our investment portfolio, which could require us to change our minimum average credit quality target.

The sovereign debt crisis in Europe and concerns regarding the instability of Euro-zone countries could have a material adverse effect on our business, financial condition and results of operations.

Global markets and economic conditions have been negatively impacted by the uncertainty relating to the level of sovereign debt of numerous E.U. member states, the ability of those countries to service their sovereign debt obligations and the stability of financial institutions operating within those E.U. member states. This uncertainty has and could in the future result in volatile bond yields on the sovereign debt of E.U. member states and on other European-related corporate debt held within our investment portfolio and could have material adverse impacts on financial markets and economic conditions in the E.U. and throughout the world. In addition, continuing downgrades of sovereign debt could bring down the average credit rating quality of our investment portfolio.

The interdependencies among European economies and financial institutions and between such European economies and financial institutions and those of the rest of the world have also exacerbated concern regarding the stability of European financial markets generally and certain institutions in particular. One or more Euro-zone countries could come under increasing pressure to leave the European Monetary Union or the European Union, or the Euro as the single currency of the Euro-zone could cease to exist if the European Monetary Union were dissolved. These or other actions could ultimately result in the European Union ceasing to exist. Any of these developments, or the perception that any of these developments are likely to occur, could lead to severe economic recession or depression. If one or more countries abandon the Euro or the European Monetary Union dissolves, it may result in uncertainty with respect to the terms, value or enforceability of these bonds, instruments or contracts, which could result in a material loss to us. Similarly, if a country leaving the Euro-zone imposes currency controls, such controls may have a material adverse impact on the value of and our ability to withdraw funds from that country.

Given the extent of our European operations, including that XL-Ireland is domiciled in Ireland, and our European investment holdings, clients and counterparties, persistent volatility in the European financial markets, or the failure of any significant European financial institution arising from the wider implications of the crisis, even if not an immediate counterparty to us, could have a material adverse impact on our business, investment portfolio, liquidity or financial performance. If the current Euro-zone sovereign debt crisis persists or worsens, it could lead to further political uncertainty, material changes to tax policies of Euro-zone countries, financial turmoil and social unrest, affecting the successful implementation of stability measures. Sovereigns, financial institutions and companies may become subject to liquidity shortages and be unable to obtain refinancing or new funding, leading to an increased risk of a default on their existing debt, and measures to reduce debt levels and fiscal deficits could result in a further slowdown of or negative economic growth.

For a discussion of the risks to our business during or following a financial market disruption and risks to our investment portfolio, see the risk factor entitled We are exposed to significant capital markets risk related to changes in interest rates, credit spreads, equity prices and foreign exchange rates as well as other investment risks, which may adversely affect our results of operations, financial condition or cash flows. For a discussion of risks associated with the United States credit rating, see the risk factor entitled Downgrading of the United States credit rating could have a

material adverse effect on our business, financial condition and results of operations.

Our efforts to develop new products or expand in targeted markets may not be successful and may create enhanced risks.

A number of our recent and planned business initiatives involve developing new products or expanding existing products in targeted markets. This includes the following efforts, from time to time, to protect or profitably grow market share:

- We may develop products that insure risks we have not previously insured or contain new coverage or coverage terms.
- We may refine our underwriting processes.
- We may seek to expand distribution channels.
- We may focus on geographic markets within or outside of the United States where we have had relatively little or no market share or operating history.

We may not be successful in introducing new products or expanding in targeted markets and, even if we are successful, these efforts may create enhanced risks. Among other risks:

- Demand for new products or in new

markets may not meet our expectations.

To the extent we are able to market new products or expand into new markets, our risk exposures may change, and the data and models we use to manage such exposures may not be as sophisticated as those we use in existing markets or with existing products. This, in turn, could lead to losses in excess of our expectations.

Efforts to develop new products or markets have the potential to create or increase distribution channel conflict.

In connection with the conversion of existing policyholders to a new product, some policyholders pricing may

increase, while the pricing for other policyholders may decrease, the net impact of which could negatively impact retention and margins.

To develop new products or markets, we may encounter unanticipated operational issues or we may need to make substantial capital and operating expenditures, which may also negatively impact results.

If our efforts to develop new products or expand in targeted markets are not successful, our results could be materially and adversely affected.

We are exposed to significant capital markets risk related to changes in interest rates, credit spreads, equity prices and foreign exchange rates as well as other investment risks, which may adversely affect our results of operations, financial condition or cash flows.

Our operating results are affected by the performance of our investment portfolio. Our assets are invested by a number of investment management service providers under the direction of the Company s management within the Investment Group in accordance, in general, with detailed investment guidelines set by us under the oversight of the RFC, and established in accordance with our SAA framework for our P&C and Life operations investment portfolios. Although our investment policies stress diversification of risks and conservation of principal and liquidity, our investments are subject to market-wide risks, as noted below, and fluctuations, as well as to risks inherent in particular securities. We are exposed to significant capital markets risks related to changes in interest rates, credit spreads and defaults, market liquidity, equity prices and foreign currency exchange rates. If significant continued market volatility, changes in interest rates, changes in credit spreads and defaults, a lack of pricing transparency, a reduction in market liquidity, declines in equity prices, and the strengthening or weakening of foreign currencies against the U.S. dollar occur, individually or together, this could have a material adverse effect on our consolidated results of operations, financial

condition or cash flows through realized losses, impairments, and changes in unrealized positions. Levels of write-down or impairment are impacted by our assessment of the intent to sell securities that have declined in value as well as actual losses as a result of defaults or deterioration in estimates of cash flows. We periodically review our investment portfolio structure and strategy. If, as a result of such review, we determine to reposition or realign portions of the investment portfolio and sell securities in an unrealized loss position, we will incur an other than temporary impairment charge. Any such charge may have a material adverse effect on our results of operations and business.

For the year ended December 31, 2012, as a result of the prolonged and continued volatility and disruptions in the public debt and equity markets, we incurred realized and unrealized investment losses, as described in Management s Discussion and Analysis of Financial Condition and Results of Operations under Part II, Item 7 of this report. We continue to closely monitor current market conditions and evaluate the long term impact of this market volatility on all of our investment holdings. Depending on market conditions, we could incur additional realized and unrealized losses in future periods, which could have a material adverse effect on the Company s results of operations, financial condition and business.

Our exposure to interest rate risk relates primarily to the market price and cash flow variability of fixed income instruments that are associated with changes in interest rates. Our investment portfolio contains interest rate sensitive instruments, such as fixed income securities, which have been and may continue to be adversely affected by changes in interest rates from central bank monetary policies, domestic and international economic and political conditions and other factors beyond our control. A rise in interest rates would increase the net unrealized loss position of our investment portfolio, offset by our ability to earn higher rates of return on funds reinvested over time. Conversely, a decline in interest rates would decrease the net unrealized loss position of our investment portfolio, offset by lower rates of return on funds reinvested. We maintain a P&C investment portfolio with diversified maturities that has a weighted average duration that is determined in accordance with its SAA Benchmark based on a dynamic financial analysis of investment assets and liabilities, and that is intended to maximize the Company s enterprise value subject to accounting, regulatory, capital and risk tolerances. The SAA Benchmarks and portfolios supporting our Life operations are rebalanced regularly to reflect an explicit asset-liability management process. However, for both the P&C and Life operations investment portfolios our estimates of the time and size of our estimated loss payment profile may be inaccurate and despite stochastic investment portfolio modeling, we may be forced to liquidate investments prior to maturity at a loss in order to cover liabilities. In sum, we are economically exposed to interest rate risk on our capital and to the extent that our investment portfolio maturities are a poor hedge of actual liability loss payments.

Our exposure to credit spread risk relates primarily to the market price associated with changes in prevailing market credit spreads and the impact on our holdings of spread products such as corporate and structured and credit-sensitive government-related securities. Approximately 2.8% of our aggregate fixed income portfolio consists of below investment-grade high yield fixed income securities. These securities have a higher degree of credit or default risk and a greater exposure to credit spread risk. Certain sectors within the investment and below investment grade fixed income market, such as structured and corporate credit, may be less liquid in times of economic weakness or market disruptions. While we have put in place procedures to monitor the credit risk and liquidity of our invested assets in general and those impacted by recent credit market issues specifically, it is possible that, in periods of economic weakness or periods of turmoil in capital markets, we may experience default losses in both our investment grade and below investment grade corporate and structured holdings. This may result in a material reduction of net income, capital and cash flows.

We invest a portion of our investment portfolio in common stock or equity-related securities, including alternative funds, private equity funds and other funds. The value of these assets fluctuates, due to changes in the equity and credit markets along with other factors. In times of economic weakness, the market value and liquidity of these assets may decline, and may impact net income, capital and cash flows. In addition, certain of the products offered by our Life operations offer fixed guaranteed returns while debt and equity yields may continue to decline. In addition, the amount of earnings from alternative funds, private investment funds and other funds are not earned evenly across the year, or even from year to year. As a result, the amount of earnings that we record from these investments may vary substantially from quarter to quarter. The timing of distributions from such private investment funds depends on particular events relating to the underlying investments. The ability of an alternative fund to satisfy any redemption request from its investors depends on the underlying liquidity of the alternative fund s investments. As a result, earnings, distributions and redemptions from these two asset classes may be more difficult to predict, and, if such funds are unable to satisfy our redemption requests, our results of operations, financial condition and cash flows may be adversely impacted. As alternative and private investment funds are collective investment vehicles managed by

third parties, we do not control the proceeds once we make our investments, thus subjecting us to a higher level of fraud risk than is the case with our fixed income and equity holdings.

The functional currencies of our principal insurance and reinsurance subsidiaries include the U.S. dollar, U.K. sterling, the Euro, the Swiss franc and the Canadian dollar. Exchange rate fluctuations relative to the functional currencies may materially impact our financial position, results of operations and cash flows. Many of our non-U.S. subsidiaries maintain both assets and liabilities in currencies different than their functional currency, which exposes us to changes in currency exchange rates.

In addition, locally-required capital levels are invested in local currencies in order to satisfy regulatory requirements and to support local insurance operations regardless of currency fluctuations. Foreign exchange rate risk is reviewed as part of our risk management process and we utilize derivative instruments such as futures, options and foreign currency forward contracts to, among other things, manage our foreign currency exposure. It is possible that these instruments will not effectively mitigate all or a substantial portion of our foreign exchange rate risk, which could adversely impact the Company s results of operations.

Certain of our investments may be illiquid or are in asset classes that have in times of market stress experienced significant market valuation fluctuations.

We hold certain investments that may lack liquidity or for which the availability of prices or inputs may be reduced in periods of market dislocation, such as non-agency residential mortgage-backed and collateralized debt obligations securities. Even some of our high quality assets have been more illiquid during periods of challenging market conditions. Generally, securities classified as Level 3 pursuant to the fair value hierarchy set forth in authoritative accounting guidance over fair value measurements may be less liquid, may be more difficult to value, requiring significant judgment, and may be more likely to result in sales at materially different amounts than the fair values determined by management.

If we require significant amounts of cash on short notice in excess of normal cash requirements or are required to post or return collateral in connection with certain of our reinsurance contracts, credit agreements, derivative transactions or our invested portfolio, we may have difficulty selling these investments in a timely manner, be forced to sell them for less than we otherwise would have been able to realize, or both.

The reported values of our relatively illiquid types of investments and, in certain circumstances, our high quality, generally liquid asset classes, do not necessarily reflect the lowest current market bid price for the asset. If we were forced to sell certain of our assets in the market, there can be no assurance that we will be able to sell them for the prices at which we have recorded them and we may be forced to sell them at significantly lower prices, particularly at times of extreme market illiquidity. Any such sales could adversely impact the Company s financial position.

If actual claims exceed our loss reserves, or if changes in the estimated levels of loss reserves are necessary, our financial results and cash flows could be adversely affected.

Our results of operations and financial condition depend upon our ability to assess accurately the potential losses associated with the risks that we insure and reinsure. We establish reserves for unpaid losses and loss adjustment expense (LAE) liabilities, which are estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. The process of establishing reserves for property and casualty claims can be complex and is subject to considerable variability, as it requires the use of informed estimates and judgments. Actuarial estimates of unpaid loss and LAE liabilities are subject to potential errors of estimation, which could be significant, due to the fact that the ultimate disposition of claims incurred prior to the date of such estimation, whether reported or not, is subject to the outcome of events that have not yet occurred. Examples of these events include the accuracy of the factual information on which the estimates were based, especially as estimates develop, jury decisions, court interpretations, legislative changes, changes in the medical condition of claimants, public attitudes, and economic conditions such as inflation.

Recent deficit spending by governments in the Company s major markets exposes the Company to heightened risk of inflation. Inflation in relation to medical costs, construction costs and tort issues in particular impact the property and casualty industry. However, broader market inflation also poses a risk of increasing overall loss costs. The impact of inflation on loss costs could be more pronounced for those lines of business that are considered long tail such as general liability, as they require a relatively long period of time to finalize and settle claims for a given accident year. Changes in the level of inflation also result in an increased level of uncertainty in our estimation of loss reserves, particularly for long tail lines of business. The estimation of loss reserves may also be more difficult during times of adverse economic

conditions due to unexpected changes in behavior of claimants and policyholders, including an increase in fraudulent reporting of exposures and/or losses, reduced maintenance of insured properties or increased frequency of small claims.

Similarly, the actual emergence of claims for life business may vary from the assumptions underlying the policy benefit reserves, in particular, the future assumed mortality improvements on the blocks of in-payment annuities.

We have an actuarial staff in each of our operating segments and a Chief Actuary who regularly evaluates the levels of loss reserves, taking into consideration factors that may impact the ultimate losses incurred. Any such evaluation could result in future changes in estimates of losses or reinsurance recoverable and would be reflected in our results of operations in the period in which the estimates are changed. Losses and LAE, to the extent that they exceed the applicable reserves, are charged to income as incurred. The reserve for unpaid losses and LAE represents the estimated ultimate losses and LAE less paid losses and LAE, and comprises case reserves and IBNR. During the loss settlement period, which can span many years in duration for casualty business, additional facts regarding individual claims and trends often will become known and case reserves may be adjusted by allocation from IBNR without any change in the overall reserve. In addition, application of statistical and actuarial methods may require the adjustment of the overall reserves upward or downward from time to time. Accordingly, the ultimate settlement of losses may be significantly greater than or less than reported loss and loss expense reserves.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social, political and other environmental conditions change, unexpected issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims, such as the effects that disruptions in the credit markets could have on the number and size of reported claims under directors and officers liability insurance (D&O) and professional liability insurance lines of business. In some instances, these changes may not become apparent until some time after we have issued the insurance or reinsurance contracts that are affected by the changes. Historically such claims and coverage issues have occurred at heightened levels during periods of very soft market conditions which often reflect an inflection point in the typical cycle of insurance industry market conditions. In addition, our actual losses may vary materially from our current estimate of the loss based on a number of factors, including receipt of additional information from insureds or brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. As a result, the full extent of liability under an insurance or reinsurance contract may not be known for many years after such contract is issued and a loss occurs.

There can be no assurance as to the effect that governmental and regulatory actions will have on the marketplace generally or on us in particular.

In response to the financial crises affecting the banking system and financial markets and going concern threats to financial institutions, there have been numerous regulatory and governmental actions in the United States, the U.K. and the Euro-zone, among other countries. The purpose of these legislative and regulatory actions is to stabilize the U.S. and international financial markets, improve the flow of credit, increase employment levels and foster an economic recovery.

Under the Dodd-Frank Act, the Financial Stability Oversight Council (FSOC) has issued rules establishing the process and criteria by which companies may be designated as nonbank systemically important financial institutions (SIFIs) subject to the examination, enforcement and supervisory authority of the FSOC. Similarly, the Financial Stability Board (FSB), consisting of representatives of national financial authorities of the G20 nations, has issued a series of frameworks and recommendations intended to produce significant changes in how financial companies, particularly global systemically important financial institutions (G- SIFIs), should be regulated. These frameworks and recommendations address issues such as financial group supervision, capital and solvency standards, systemic

economic risk, corporate governance including compensation, and a host of related issues associated with responses to the financial crisis. In addition, the FSB has directed the International Association of Insurance Supervisors (IAIS) to create standards relative to these areas for global systemically important insurers (G-SIIs) and incorporate them within that body s Insurance Core Principles. While we do not expect that we will be designated as a SIFI,

G-SIFI or G-SII, certain of our competitors may be so designated, which may impact market behavior and/or access to capital.

With respect to our investment portfolio, we own a number of Tier 1 and Upper Tier 2 hybrid securities issued by financial institutions including those based in the U.S., Europe and the U.K. There is a risk that, if the capital positions of financial institutions deteriorate further government intervention, particularly nationalization of such institutions, could occur. There is also a risk of regulatory imposed deferral of coupons or decisions by bank management not to call the capital or defer the coupon payments. This may result in losses on the hybrid securities we hold. There is also the risk of further downgrades of these or other securities as rating agencies re-evaluate their rating methodologies, which would negatively impact the regulatory capital of the Life operations or the valuation of our investment portfolio assets generally.

In particular, the current sovereign debt crisis concerning European countries, including Greece, Italy, Ireland, Portugal and Spain, or GIIPS, and related European financial restructuring efforts, may cause the value of the European currencies, including the Euro, to further deteriorate, which in turn could adversely impact Euro-denominated assets held in our investment portfolio or our European book of business. In addition, the European crisis is contributing to instability in global credit markets, as well as the widening of bond yield spreads. Rating agency downgrades on European sovereign debt and continuing concern about the potential default of government issuers or a possible break-up of the European Union has further contributed to this uncertainty. Should governments default on their obligations, there will be a negative impact on both our direct holdings, as well as on non-government issues and financials held within the country of default. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Balance Sheet Analysis European Sovereign Debt Crisis for an analysis of our fixed maturity portfolio s exposure to GIIPS.

There can be no assurance as to the effect that any such governmental actions or future regulatory initiatives may have on certain investment instruments in our investment portfolio, or on our competitive position, business or financial position. If global economic and market conditions remain uncertain and volatile, or deteriorate further, we may experience material adverse impacts on our results of operations, financial condition and cash flows.

We may be unable to purchase reinsurance and, even if we are able to successfully purchase reinsurance, we are subject to the possibility of being unable to collect reinsurance when due.

We purchase reinsurance for our own account in order to mitigate the volatility that losses impose on our financial condition. Our clients purchase reinsurance from us to cover part of the risk originally written by them. Retrocessional reinsurance involves a reinsurer ceding to another reinsurer, the retrocessionaire, all or part of the reinsurance that the first reinsurer has assumed. Reinsurance, including retrocessional reinsurance, does not legally discharge the ceding company from its liability with respect to its obligations to its insureds or reinsureds. A reinsurer s or retrocessionaire s insolvency, inability or refusal to make timely payments under the terms of its agreements with us, therefore, could have a material adverse effect on us because we remain liable to our insureds and reinsureds. For further information regarding our reinsurance exposure, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

From time to time, market conditions may limit or prevent us from obtaining the types and amounts of reinsurance that we consider adequate for our business needs such that we may not be able to obtain reinsurance or retrocessional reinsurance from entities with satisfactory creditworthiness in amounts that we deem desirable or on terms that we deem appropriate or acceptable.

The impairment of other financial institutions could adversely affect us.

We have exposure to counterparties in various industries, including banks, hedge funds and other investment vehicles, and in reinsurance and other transactions, including derivative transactions. Many of these transactions expose us to

credit risk in the event our counterparty fails to perform its obligations. Even if we are entitled to collateral when a counterparty defaults, such collateral may be illiquid or proceeds from such collateral when liquidated may not be sufficient to recover the full amount of the obligation. We also have exposure to financial institutions in the form of secured and unsecured debt instruments and equity securities. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Since we depend on a few brokers for a large portion of our revenues, loss of business provided by any one of them could adversely affect us.

We market our insurance and reinsurance products worldwide primarily through insurance and reinsurance brokers. AON Corporation, Marsh & McLennan Companies and the Willis Group and their respective subsidiaries each provided significant portions of our gross written premiums for property and casualty operations. Loss of all or a substantial portion of the business provided by one or more of these brokers could have a material adverse effect on our business.

Our reliance on brokers subjects us to credit risk.

In certain jurisdictions, when an insured or ceding insurer pays premiums for policies of insurance or contracts of reinsurance to brokers for further payment to us, such premiums might be considered to have been paid and the insured or ceding insurer will no longer be liable to us for such amounts, whether or not we have actually received the premiums from the broker. In addition, in accordance with industry practice, we generally pay amounts owed on claims under our reinsurance contracts to brokers, and these brokers, in turn, pay these amounts over to the clients that have purchased reinsurance from us. Although the law is unsettled and depends upon the facts and circumstances of the particular case, in some jurisdictions, if a broker fails to make such a claims payment to the insured or ceding insurer, we might remain liable to the insured or ceding insurer for that non-payment. Consequently, we assume a degree of credit risk associated with the brokers with whom we transact business. Due to the unsettled and fact-specific nature of the law governing these types of scenarios and our lack of historical experience with such risks, we are unable to quantify our exposure to this risk.

We are subject to a number of risks associated with our business in emerging markets.

Our insurance and reinsurance subsidiaries conduct business outside the United States, primarily in the U.K., Bermuda, and Europe. We have also continued to pursue opportunities in other countries, including in emerging markets such as Asia, Africa and Latin America. In conducting such business we are subject to a number of significant risks. These risks include restrictions such as price controls, capital controls, exchange controls, ownership limits and other restrictive governmental actions, which could have an adverse effect on our business and our reputation. In addition, some countries, particularly emerging economies, have laws and regulations that lack clarity and, even with local expertise and effective controls, it can be difficult to determine the exact requirements of the local laws. Failure to comply with local laws in a particular market could have a significant and negative effect not only on our business in that market but also on our reputation generally.

Our holding company structure and certain regulatory and other constraints affect our ability to pay dividends, make payments on our debt securities and make other payments.

Our ability to pay dividends or return capital from shareholders equity is limited by applicable laws and regulations of the various jurisdictions in which our principal operating subsidiaries operate, certain additional required regulatory approvals and financial covenants contained in our letters of credit and revolving credit facilities.

As holding companies, XL-Ireland and XL-Cayman have no operations of their own and their assets consist primarily of investments in subsidiaries. Accordingly, XL-Ireland and XL-Cayman rely on the availability of dividends and other permissible payments from subsidiaries to make principal and interest payments on debt, to pay operating expenses and ordinary and preferred shareholder dividends, to make capital investments in subsidiaries and to pay other obligations that may arise from time to time. The payment of dividends to us by our insurance and reinsurance subsidiaries is regulated under the laws of the various countries and states, including Bermuda, the U.K., Ireland, Switzerland and in the other jurisdictions where we have regulated subsidiaries, by certain insurance statutes of various states in the United States in which our insurance and reinsurance subsidiaries are licensed to transact business and by the Society of Lloyd s. For further information regarding regulatory restrictions governing the payment of

dividends by the Company s significant property and casualty subsidiaries in Ireland, Bermuda and the U.S., see Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements, and Item 1, Business Regulation.

XL-Ireland is subject to certain legal constraints that affect its ability to pay dividends on or redeem or buyback our ordinary shares. While XL-Ireland s articles of association authorize its board of directors to

declare and pay dividends as justified from the profits, under Irish law, XL-Ireland may only pay dividends or buyback or redeem shares using distributable reserves. On July 23, 2010, the Irish High Court approved XL-Ireland s conversion of share premium to $5.0 billion of distributable reserves, subject to the completion of certain formalities under Irish Company law. These formalities were completed in early August 2010. As of December 31, 2012, XL-Ireland had $3.6 billion in distributable reserves. In addition, no dividend or distribution may be made unless the net assets of XL-Ireland are not less than the aggregate of its share capital plus undistributable reserves and the distribution does not reduce XL-Ireland s net assets below such aggregate.

In addition, XL-Cayman is subject to certain constraints that affect its ability to pay dividends on its preferred shares. Under Cayman Islands law, XL-Cayman may not declare or pay a dividend if there are reasonable grounds for believing that XL-Cayman is, or would after the payment be, unable to pay its liabilities as they become due in the ordinary course of business. Also, the terms of XL-Cayman s preferred shares prohibit declaring or paying dividends on the ordinary shares unless full dividends have been declared and paid on the outstanding preferred shares.

The ability to declare and pay dividends may also be restricted by financial covenants in our letters of credit and revolving credit facilities. We were in compliance with all covenants by significant margins at December 31, 2012, and currently remain in compliance.

We may require additional capital in the future, which may not be available to us on satisfactory terms, on a timely basis or at all.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover our losses. To the extent that the funds generated by our ongoing operations are insufficient to fund future operating requirements and cover claim payments, or that our capital position is adversely impacted by mark-to-market changes on the investment portfolio, catastrophe events or otherwise, we may need to raise additional funds through financings or curtail our growth and reduce our assets. As a result of the current severe economic conditions that persist in the capital markets, any future financing may not be available on terms that are favorable to us, if at all. Our letter of credit facilities are needed to a significant extent for U.S. cedants, and are effective for such cedants only if the banks issuing letters of credit are on the list of National Association of Insurance Commissioners (NAIC) approved banks. If some or all of the issuing banks under our credit facilities cease to be NAIC approved, whether arising from macroeconomic or bank specific events, and we are unable to replace non-approved banks with NAIC approved banks, our letter of credit facility capacity could be significantly diminished. In addition, in the case of a macroeconomic event, such as dissolution of the European Monetary Union, the availability of alternative lending sources may be significantly reduced or non-existent, and the cost of replacement facilities may be significantly increased or prohibitive. Any future equity financings could be dilutive to our existing shareholders or could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. Our inability to obtain adequate capital could have a material adverse effect on our business, financial condition and results of operations.

Competition in the insurance and reinsurance industries could reduce our operating margins.

The insurance and reinsurance industries are highly competitive. We compete on an international and regional basis with major U.S., Bermudian, European and other international insurers and reinsurers and with underwriting syndicates, some of which have greater financial and management resources and higher ratings than we have. We also compete with new companies that continue to be formed to enter the insurance and reinsurance markets and with alternative products that are intended to compete with reinsurance products, such as insurance/risk-linked securities, catastrophe bonds and derivatives. In recent years capital market participants have been increasingly active in the reinsurance market and markets for related risks. Increased competition could result in fewer submissions, lower premium rates and less favorable policy terms and conditions, which could reduce our margins.

Operational risks, including human or systems failures, are inherent in our business.

Losses can result from operational risk such as, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, failure to appropriately transition new hires or external events. Areas of operational risk can be heightened in discontinued or exited businesses as a result of

reduced overall resource allocation and the loss of relevant knowledge and expertise by departing management.

We operate globally, and have two office locations in India that currently provide large portions of our back office support. Our global operations present significant operational risk due to the possibility of disruptions in communication or information processes, whether due to technical difficulties, power failures or destruction or damage to our offices for any reason. If any disruption occurs, our business continuity and disaster recovery plans may not be effective, particularly if natural or man-made catastrophic events occur, and such disruption could harm our results of operations or our reputation in the marketplace.

We believe that our modeling, underwriting and information technology and application systems are critical to our business, as our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Moreover, our information technology and application systems have been important to our underwriting process and our ability to compete successfully. Our business depends on effective information systems and the integrity and timeliness of the data we use to run our business. Our ability to adequately price products and services, to establish reserves, to provide effective and efficient service to our clients, and to timely and accurately report our financial results also depends significantly on the integrity of the data in our information systems and processes supporting them. Failure of any of these systems or inaccuracies in the data stored therein may jeopardize our ability to service and interact with clients, which could result in significant losses or reputational damage. In addition, we have licensed certain systems and data from third parties. We cannot be certain that we will have access to these, or comparable, service providers, or that our information technology or application systems will continue to operate as intended. We also have outsourced the day-to-day management, custody and record-keeping of our investment portfolio to third-party managers and custodians that we believe to be reputable. A major defect in those investment managers investment management strategy, or decision-making could result in management distraction and/or significant financial loss. We also rely on a few brokers for a large portion of our revenues. A major defect in our brokers , investment managers or custodians internal controls or information and technology systems could result in management distraction or significant financial loss.

Any ineffectiveness in our internal controls, information technology, application systems, investment management or custody and record keeping could have a material adverse effect on our business.

System security risks, data protection breaches and cyber-attacks could adversely affect our business and results of operations.

Our internal control and information technology and application systems may be vulnerable to threats from computer viruses, natural disasters, unauthorized access, cyber attack and other similar disruptions. Experienced computer programmers and hackers may be able to penetrate our network s system security measures and misappropriate or compromise confidential information, create system disruptions or cause shutdowns. In addition to our own confidential information, as a (re)insurer, we receive and are required to protect confidential information from clients and other third parties. To the extent any disruption or security breach results in a loss or damage to our data, or inappropriate disclosure of our confidential information or that of others, it could cause significant damage to our reputation, affect our relationships with our customers and clients, lead to claims against us, result in regulatory action and ultimately have a material adverse effect on our business. In addition, we may be required to incur significant costs to mitigate the damage caused by any security breach, or to protect against future damage.

Unanticipated losses from terrorism and uncertainty surrounding the future of the TRIPRA could have a material adverse effect on our financial condition, results of operations and cash flows.

The U.S. Terrorism Risk Insurance Act of 2002 (TRIA), as amended, established the Terrorism Risk Insurance Program (TRIP), which became effective on November 26, 2002 and was a three-year federal program effective through 2005. On December 22, 2005, President George W. Bush signed a bill extending TRIA (TRIAE) for two more years, continuing TRIP through 2007. On December 26, 2007, President George W. Bush signed the Terrorism

Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) which further extended TRIP for seven years until December 31, 2014 and also eliminated the distinction between foreign and domestic acts of terrorism.

In response to the tightening of supply in certain insurance and reinsurance markets resulting from, among other things, the September 11 event, the TRIP was created upon the enactment of the TRIA of

2002 to ensure the availability of commercial insurance coverage for certain terrorist acts in the U.S. This law established a federal program, that has now been extended to December 31, 2014, to help the commercial property and casualty insurance industry cover claims related to future terrorism-related losses and required that coverage for terrorist acts be offered by insurers.

TRIA voided in force terrorism exclusions as of November 26, 2002 for certified terrorism on all TRIA specified property and casualty business. TRIA required covered insurers to make coverage available for certified acts of terrorism on all new and renewal policies issued after TRIA was enacted. TRIA along with further extensions to TRIP, as noted above, allows us to assess a premium charge for terrorism coverage and, if the policyholder declines the coverage or fails to pay the buy-back premium, certified acts of terrorism may then be excluded from the policy, subject, however, to state specific requirements. Terrorism coverage cannot be excluded from workers compensation policies. Subject to a premium-based deductible and provided that we have otherwise complied with all the requirements as specified under TRIPRA, we are eligible for reimbursement by the Federal Government for up to 85% of our covered terrorism-related losses arising from a certified terrorist attack. Such payment by the government will, in effect, provide reinsurance protection on a quota share basis. The maximum liability during a program year, including both the Federal Government s and insurers shares, is capped on an aggregated basis at $100 billion. While regulations have been promulgated by the Department of the Treasury (Treasury) requiring that Treasury advise participating insurers, such as the Company, in advance of reaching the $100 billion aggregate limit that such aggregate limit could be reached during the program year, there is a risk that the Company will not be given adequate notice of the potential exhaustion of that aggregate limit. Accordingly, the Company could overpay with regard to such losses, and it is unlikely Treasury would reimburse the Company for such losses; moreover, it is unclear whether the Company, in the event of an overpayment, would be able to recover the amount of any such overpayment.

We believe that TRIP and the related legislation have been an effective mechanism to assist policyholders and industry participants with the extreme contingent losses that might be caused by acts of terrorism. Nevertheless, we cannot provide assurance that TRIPRA will be extended beyond 2014, and its expiration or a significant change in terms could have an adverse effect on us, our clients or the insurance industry.

The regulatory regimes under which we operate, and potential changes thereto, could have a material adverse effect on our business.

Our insurance and reinsurance subsidiaries operate in more than 20 countries around the world as well as in all 50 U.S. states. Our operations in each of these jurisdictions are subject to varying degrees of regulation and supervision. The laws and regulations of the jurisdictions in which our insurance and reinsurance subsidiaries are domiciled require, among other things, these subsidiaries to maintain minimum levels of statutory capital, surplus and liquidity, meet solvency standards, submit to periodic examinations of their financial condition and restrict payments of dividends, distributions and reductions of capital in certain circumstances. Statutes, regulations and policies that our insurance and reinsurance subsidiaries are subject to may also restrict the ability of these subsidiaries to write insurance and reinsurance policies, make certain investments and distribute funds.

In recent years, the U.S. insurance regulatory framework has come under increased federal scrutiny. In July 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act requires many federal agencies to adopt new rules and regulations that will apply to the financial services industry and also calls for many studies regarding various industry practices. In particular, the Dodd-Frank Act created a Federal Insurance Office within the Treasury that is focused on national coordination of the insurance sector, systemic risk mitigation and international regulatory cooperation. Although the Federal Insurance Office currently does not directly regulate the insurance industry, under the Dodd-Frank Act it has the power to preempt state insurance regulations that are inconsistent with international agreements regarding insurance regulation, subject to certain exceptions. In addition, the Dodd-Frank Act provides that the Federal Insurance Office must submit a report to Congress on improving U.S. insurance regulation, which must cover the feasibility of future federal regulation of the U.S. insurance industry. This study or one of the various other studies required by the legislation could result in additional rulemaking or legislative action, which could

negatively impact our business and financial results. While we have not yet been required to make material changes to our business or operations as a result of the Dodd-Frank Act, due to the complexity and broad scope of the Dodd-Frank Act and the time required for regulatory implementation, it is not certain what the scope of

future rulemaking or interpretive guidance from the SEC, CFTC or other regulatory agencies may be, and what impact this will have on our compliance costs, business, operations and profitability.

In addition, some state legislatures have considered or enacted laws that may alter or increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the NAIC, which is the organization of insurance regulators from the 50 U.S. states, the District of Columbia and the four U.S. territories, as well as state insurance regulators, regularly reexamine existing laws and regulations.

In addition to these proposals and initiatives in the United States, new capital adequacy and risk management regulations, called Solvency II, were expected to be implemented throughout the European Union by January 1, 2014. However, due to a delay in the vote on the Omnibus II directive by the European Parliament from October 22, 2012, then to November 20, 2012 to the current schedule of March 2013, it is widely accepted that this implementation date will not be met. The Central Bank of Ireland has informed us that it will be our group supervisor under Solvency II. See Business – Regulation . Regulations and legislation relating to capital adequacy and risk management are also in the process of being developed or implemented in other jurisdictions. There remains significant uncertainty as to the impact that these various regulations and legislation will have on us; however, such impact could include constraints on our ability to move capital between subsidiaries or require that additional capital be provided to subsidiaries in certain jurisdictions, which may impact our profitability.

Our Bermuda-based operating subsidiaries are subject to the BMA s risk-based capital standards for (re)insurance companies, which impose required levels of statutory capital and surplus on our Bermuda-based operating standards. While our Bermuda-based operating subsidiaries currently have excess capital and surplus under these requirements, there can be no assurance that such requirements or similar regulations, in their current form or as may be amended in the future, will not have a material adverse effect on our business, financial condition or results of operations.

We may not be able to comply fully with, or obtain desired exemptions from, revised statutes, regulations and policies that govern the conduct of our business. Failure to comply with, or to obtain desired authorizations and/or exemptions under, any applicable laws could result in restrictions on our ability to do business or undertake activities that are regulated in one or more of the jurisdictions in which we operate and could subject us to fines and other sanctions. In addition, changes in the laws or regulations to which we are, or may become subject, or in the interpretations thereof by enforcement or regulatory agencies, could have a material adverse effect on our business, financial condition and results of operations.

Potential government intervention in our industry as a result of recent events and instability in the marketplace for insurance products could hinder our flexibility and negatively affect the business opportunities that may be available to us in the market.

Government intervention and the possibility of future government intervention have created uncertainty in the insurance and reinsurance markets. Government regulators are generally concerned with the protection of policyholders to the exclusion of other constituencies, including shareholders of insurers and reinsurers. While we cannot predict the exact nature, timing or scope of possible governmental initiatives, such proposals could adversely affect our business by, among other things:

- providing insurance and reinsurance capacity in markets and to consumers that we target, e.g.,

- the creation or expansion of state or federal catastrophe funds such as those in Florida;
- requiring our participation in industry pools and guarantee associations;
- expanding the scope of coverage or altering the enforceability of deductibles under existing policies;
- regulating the terms of insurance and reinsurance policies;
- ordering the suspension of or otherwise altering the application of insurance laws or regulations; or
- disproportionately benefiting the companies of one country over those of another.

The insurance industry is also affected by political, judicial and legal developments that may create new and expanded theories of liability, which may result in unexpected claims frequency and severity and delays or cancelations of products and services by insureds, insurers and reinsurers which could adversely affect our business.

For further information regarding government regulation and/or intervention in response to the financial and credit crises, see risk factor entitled There can be no assurance as to the effect that governmental actions will have on the marketplace generally or on us in particular above.

Consolidation in the insurance industry could adversely impact us.

Insurance industry participants may seek to consolidate through mergers and acquisitions. Continued consolidation within the insurance industry will further enhance the already competitive underwriting environment as we would likely experience more robust competition from larger, better capitalized competitors. These consolidated entities may use their enhanced market power and broader capital base to negotiate price reductions for our products and services, and reduce their use of reinsurance, and, as such, we may experience rate declines and possibly write less business.

The loss of one or more key executives or the inability to attract, motivate and retain qualified personnel could adversely affect our ability to conduct business.

Our success depends on our ability to attract new, highly skilled individuals and to motivate and retain our existing key executives and qualified personnel. The loss of the services of any of our key executives or the inability to attract, motivate and retain other highly skilled individuals in the future could adversely affect our ability to conduct our business. In addition, we do not maintain key man life insurance policies with respect to our employees.

A decrease in the fair values of our reporting units may result in future goodwill impairments.

When we acquire an entity, the excess of the purchase price over the net identifiable assets acquired is allocated to goodwill. We conduct impairment tests on our reported goodwill at least annually or more frequently if impairment indicators exist. In performing a goodwill impairment test, we use various methods and make various assumptions to determine the fair value of our reporting units, including the determination of expected future cash flows and/or profitability of such reporting units, and we take into account market value multiples and/or cash flows of entities that we deem to be comparable in nature, scope or size to our reporting units. However, expected future cash flows and/or profitability may be materially and negatively impacted as a result of, among other things, a decrease in renewal activity and new business opportunities, a decrease in retention or our underwriting teams, lower-than-expected yields and/or cash flows from our investment portfolio or higher-than-expected claims activity and magnitude of incurred losses and general economic factors that impact the reporting unit. In addition, previously determined market value multiples and/or cash flows may no longer be relevant as a result of these potential factors. As a result of these potential changes, the estimated fair value of one or more of our reporting units may decrease, causing the carrying value of the net assets assigned to the reporting unit to exceed the fair value of such net assets. If we determine an impairment exists, we adjust the carrying value of goodwill to its implied fair value. The impairment charge is recorded in our income statement in the period in which the impairment is determined. If we are required in the future to record additional goodwill impairments, our financial condition and results of operations would be negatively affected. In connection with fair value measurements and the accounting for goodwill, the use of generally accepted accounting principles requires management to make certain estimates and assumptions. Significant judgment is required in making these estimates and assumptions, and actual results may ultimately be materially different from such estimates and assumptions.

Provisions in our Articles of Association may reduce the voting rights of our ordinary shares.

Our Articles of Association generally provide that shareholders have one vote for each ordinary share held by them and are entitled to vote, on a non-cumulative basis, at all meetings of shareholders. However, the voting power that may be exercised by certain persons or groups may not equal or exceed 10% or more of the voting power conferred by our shares.

In particular, our Articles of Association provide that if, and for so long as, the votes conferred by the Controlled Shares (as defined below) of any person constitute 10% or more of the votes conferred by all our issued shares, the voting rights with respect to the Controlled Shares of such person shall be limited, in the aggregate, to a voting power equal to approximately (but slightly less than) 10%, pursuant to a formula set forth in the our Articles of Association. Controlled Shares of a person (as defined in our Articles of Association) include (1) all of our shares owned directly,

indirectly or constructively by that person (within the meaning of Section 958 of the Internal Revenue Code of 1986, as amended (the IRS Code), and (2) all of our shares owned directly, indirectly or constructively by that person or any group of which that person is a part, within the meaning of Section 13(d)(3) of the Exchange Act.

Provisions in our Articles of Association may restrict the ownership and transfer of our ordinary shares.

Our Articles of Association provide that our Board of Directors shall decline to register a transfer of shares if it appears to our Board of Directors, whether before or after such transfer, that the effect of such transfer would be to increase the number of Controlled Shares of any person to 10% or more of any class of our voting shares, of our total issued shares, or of the total voting power of our total issued shares.

Certain provisions in our charter documents could, among other things, impede an attempt to replace our directors or impose restrictions with respect to a change of control, which could diminish the value of our ordinary shares.

Our Articles of Association contain provisions that may make it more difficult for shareholders to replace directors and could delay or prevent a change of control that a shareholder may consider favorable. These provisions include a staggered board of directors, limitations on the ability of shareholders to remove directors, limitations on voting rights and certain transfer restrictions on our ordinary shares.

As an Irish company, we are subject to the Irish Takeover Rules, under which our Board of Directors is not permitted to take any action that might frustrate an offer for our shares once the Board of Directors has received an offer or has reason to believe an offer is or may be imminent without the approval of more than 50% of shareholders entitled to vote at a general meeting of shareholders and/or the consent of the Irish Takeover Panel. This could limit the ability of the Board of Directors to take defensive actions even if the Board of Directors believes that such defensive actions would be in the best interests of the Company and its shareholders.

The Irish Takeover Rules also could discourage an investor from acquiring 30% or more of our outstanding ordinary shares unless such investor was prepared to make a bid to acquire all outstanding ordinary shares. Further, it could be more difficult for us to obtain shareholder approval for a merger or negotiated transaction because of heightened shareholder approval requirements for certain types of transactions under Irish law.

In addition, insurance regulations in certain jurisdictions may also delay or prevent a change of control or limit the ability of a shareholder to acquire in excess of specified amounts of our ordinary shares.

Irish shareholder voting requirements may limit flexibility with respect to certain aspects of capital management.

Irish law allows shareholders to authorize a board of directors to issue shares subsequent to receipt of authorization without further shareholder approval, but this authorization must be renewed after five years. Additionally, subject to specified exceptions, Irish law grants statutory pre-emption rights to existing ordinary shareholders to subscribe for new issuances of shares for cash, but allows such shareholders to authorize the waiver of such statutory pre-emption rights for five years. Our Articles of Association currently provide authority to the Board of Directors to issue shares without further shareholder approval and to waive ordinary shareholders statutory pre-emption rights. However, these authorizations expire in 2015, unless renewed by XL-Ireland s shareholders, and we can provide no assurance that these authorizations and waivers will always be renewed, which could limit our ability to issue equity in the future.

It may be difficult to enforce judgments against XL-Ireland, XL-Cayman or their directors and executive officers.

XL-Ireland is incorporated pursuant to the laws of Ireland. In addition, certain of our directors and officers reside outside the United States and a substantial portion of our assets and the assets of such directors and officers are located outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon those persons or to recover on judgments of U.S. courts against us or our directors and officers, including judgments predicated upon civil liability provisions of U.S. federal securities laws. We have been advised that there is no treaty between Ireland and the United States providing for the reciprocal enforcement of foreign judgments. The following requirements must be met before the foreign judgment will be deemed to be enforceable in Ireland:

- the judgment must be for a definite sum;
- the judgment must be final and conclusive; and
- the judgment must be provided by a court of competent jurisdiction.

An Irish court will also exercise its right to refuse judgment if the foreign judgment was obtained by fraud, if the judgment violated Irish public policy, if the judgment is in breach of natural justice or if it is irreconcilable with an earlier foreign judgment.

In addition, XL-Cayman is incorporated pursuant to the laws of the Cayman Islands and is an Irish tax resident. Requirements for enforceability of foreign judgments in Ireland are summarized above. We have been advised that there is doubt as to whether the courts of the Cayman Islands would enforce:

- judgments of U.S. courts based upon the civil liability provisions of U.S. federal securities laws obtained in actions against XL-Cayman or its directors and officers who reside outside the United States; or

- original actions brought in the Cayman Islands against these persons or XL-Cayman predicated solely upon U.S. federal securities laws.

We have also been advised that there is no treaty in effect between the United States and the Cayman Islands providing for such enforcement and there are grounds upon which Cayman Islands courts may not enforce judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under U.S. federal securities laws, may not be allowed in Cayman Islands courts as contrary to public policy.

Current, pending or future lawsuits against us, including putative class action lawsuits, could have a material adverse effect on our results of operations in a particular fiscal quarter or year.

We are subject to lawsuits and arbitrations in the regular course of our business. An adverse resolution of one or more lawsuits or arbitrations could have a material adverse effect on our results of operations in a particular fiscal quarter or year.

Changes in current accounting practices and future pronouncements may materially impact our reported financial results.

Unanticipated developments in accounting practices may require us to incur considerable additional expenses to comply with such developments, particularly if we are required to prepare information relating to prior periods for comparative purposes or to apply the new requirements retroactively. The impact of changes in current accounting practices and future pronouncements cannot be predicted but may affect the calculation of net income, net equity and other relevant financial statement line items and the timing of when impairments and other charges are tested or taken. In particular, recent guidance and ongoing projects put in place by standard setters globally have indicated a possible move away from the current insurance accounting models toward more fair value based models which could introduce significant volatility in the earnings of insurance industry participants.

There is a possibility that the Master Agreement entered into at the time of the sale of Syncora and the related commutations and releases could be challenged or that we could be subject to litigation as a result of the Master Agreement. Any such challenge could have a material adverse effect on our financial condition, results of operations, liquidity or the market price of our securities.

We provided certain reinsurance protections (the Reinsurance Agreements) with respect to adverse development on certain transactions as well as indemnification under specific facultative and excess of loss coverages for subsidiaries of Syncora: Syncora Guarantee Re and Syncora Guarantee. At June 30, 2008, our total net exposure under facultative agreements with Syncora subsidiaries was approximately $6.4 billion of net par value outstanding. Pursuant to the closing of the Master Agreement, all of these Reinsurance Agreements were commuted.

In addition, through one or more of our subsidiaries, we entered into certain agreements with subsidiaries of Syncora pursuant to which we guaranteed certain obligations of Syncora Guarantee Re and Syncora Guarantee under specific agreements (the Guarantee Agreements). At June 30, 2008, the total net par value outstanding of business written by subsidiaries of Syncora which fell under the Guarantee Agreements was approximately $60 billion. Pursuant to the terms of, and required conditions under, the Master Agreement, Syncora Guarantee Re s facultative quota share reinsurance agreement with Syncora Guarantee, and all individual risk cessions thereunder, and the Financial Security Master Facultative

Agreement, and all individual risk cessions thereunder, were commuted, thereby rendering the Syncora Guarantee Re guarantee and Financial Security guarantee of no further force and effect.

Following the closing of the Master Agreement, Syncora and its applicable subsidiaries were required to use commercially reasonable efforts to commute the underlying financial guarantees that we had issued to the European Investment Bank (EIB) in connection with financial guaranty policies between certain subsidiaries of Syncora Holdings and EIB. This was completed in June 2010.

Under federal bankruptcy laws and comparable provisions of state fraudulent transfer laws (including those applicable in any state insurance insolvency proceeding), Syncora s commutation and release of our obligations pursuant to the Master Agreement and related agreements would constitute a voidable fraudulent transfer if it was determined that Syncora or any applicable subsidiary thereto, at the time it entered into the Master Agreement or such related agreement:

- intended to hinder, delay or defraud its creditors; or
- received less than reasonably equivalent value or fair value consideration for such release; and either:
- was insolvent or rendered insolvent by reason of such occurrence; or
- was engaged in a business or transaction for which its remaining assets constituted unreasonably small capital; or

intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

Among other regulatory approvals obtained in connection with the Master Agreement and the commutation of the Syncora Guarantee Re/Syncora Guarantee Quota Share, the New York Department of Financial Services (NYDFS) issued an approval letter to Syncora Guarantee under Section 1505 of the New York Insurance Law and the Delaware Insurance Department (DID) issued an approval letter to Syncora Guarantee Re under Section 5005(a) of the Delaware Insurance Code (effective upon Syncora Guarantee Re s redomestication to Delaware) (both of which require that the terms of a transaction between an issuer and one or more of its affiliates be fair and equitable) stating, in the case of NYDFS, that the terms of the Master Agreement and each of the commutations are fair and equitable to Syncora Guarantee and do not adversely affect policyholders of Syncora Guarantee and, in the case of the DID, stating that the terms of the Master Agreement and the commutation of the Syncora Guarantee Re/Syncora Guarantee Quota Share were fair and equitable to Syncora Guarantee. The BMA (the domiciliary regulator of Syncora Guarantee Re) also issued an approval letter approving the Master Agreement and each commutation to which Syncora Guarantee Re is a party, including the Syncora Guarantee Re/Syncora Guarantee Quota Share.

There can be no assurance that a court would agree with our, the NYDFS s, the DID s, the BMA s or Syncora s conclusions, or as to what law or standard a court would ultimately apply in making any such determination or as to how such court would ultimately rule. Further, there can be no assurance that the enforceability of the Master Agreement, the agreements relating thereto and the transactions contemplated thereunder will not be challenged, including under applicable fraudulent transfer laws and/or by asserting any number of other theories for recovery, including third-party beneficiary rights, or that other litigation will not be commenced against us as a result of the Master Agreement and such related agreements and transactions. Additionally, in the event of any liquidation or rehabilitation or similar proceeding of any insurance subsidiary of Syncora, there can be no assurance that any insurance regulator or regulators responsible for such proceedings, in their capacity as liquidator or rehabilitator, would respect the insurance regulatory approvals obtained in connection with the Master Agreement.

We and our non-U.S. insurance subsidiaries may become subject to U.S. tax, which may have a material adverse effect on our results of operations and your investment.

We take the position that neither we nor any of our non-U.S. insurance subsidiaries are engaged in a U.S. trade or business through a U.S. permanent establishment. Accordingly, we take the position that none of our non-U.S. insurance subsidiaries should be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income). However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the United States, we cannot be certain that the U.S. Internal Revenue Service (the IRS) will not contend successfully that

we or any of our non-U.S. insurance subsidiaries are engaged in a trade or business in the United States. If we or any of our non-U.S. insurance subsidiaries were considered to be engaged in a trade or business in the United States, any such entity could be subject to U.S. corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business, in which case our financial condition and results of operations could be materially adversely affected.

Changes in U.S. tax law might adversely affect an investment in our shares.

Legislation may be introduced in the U.S. Congress attempting to eliminate certain perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the U.S. but have certain U.S. affiliates. For example, one legislative proposal could impose additional limits on the deductibility of interest by foreign-owned U.S. corporations. Another legislative proposal could modify the standards that indicate when a non-U.S. corporation might be treated as a U.S. corporation for U.S. federal income tax purposes if it were considered to be primarily managed and controlled in the U.S. In addition, legislation has been proposed in the U.S. that would severely restrict the ability of a company to utilize affiliate reinsurance to manage its U.S. risks and its capital position. Various proposals have been made that would effectively disallow (in some cases permanently and in others temporarily) part or all of the deduction for premiums ceded to affiliates If any of these proposals, or a similar proposal using the same underlying principles, is enacted, the resulting impact to the Company could have an adverse impact on us or our shareholders. It is possible that other legislative proposals could emerge in the future that could also have an adverse impact on us or our shareholders.

Additionally, the U.S. federal income tax laws and interpretations, including those regarding whether a company is engaged in a trade or business (or has a permanent establishment) within the United States or is a Passive Foreign Investment Company (PFIC), or whether U.S. holders would be required to include in their gross income subpart F income or the related person insurance income, which we refer to as RPII of a Controlled Foreign Corporation (CFC), are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the PFIC rules to insurance companies and the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. We cannot be certain if, when or in what form such regulations or pronouncements may be provided and whether such guidance will have a retroactive effect.

We cannot assure you that future legislative action will not increase the amount of U.S. tax payable by us. If an increase occurs, our financial condition and results of operations could be materially adversely affected.

There is U.S. income tax risk associated with reinsurance between U.S. insurance companies and their Bermuda affiliates.

As discussed above, Congress has periodically considered legislation intended to eliminate certain perceived tax advantages of non-U.S. insurance companies and U.S. insurance companies with non-U.S. affiliates, including perceived tax benefits resulting principally from reinsurance between or among U.S. insurance companies and their non-U.S. affiliates. In this regard, section 845 of the IRS Code was amended in 2004 to permit the IRS to reallocate, recharacterize or adjust items of income, deduction or certain other items related to a reinsurance agreement between related parties to reflect the proper amount, source or character for each item (in contrast to prior law, which only covered source and character). If the IRS were to successfully challenge our reinsurance arrangements under section 845, our financial condition and results of operations could be materially adversely affected and the price of our ordinary shares could be adversely affected.

The Organization for Economic Co-operation and Development has implemented measures and may implement further measures that might change the manner in which we are taxed.

The Organization for Economic Co-operation and Development (the OECD) published its current tax agenda in May 2012. In this report, the OECD refers to a number of ongoing initiatives. Any measures implemented as a result of

these initiatives could have an impact on how we and other multinational organizations are taxed. We are not able to predict the impact on our tax position from the implementation of any such measures.

The OECD s Report on the Attribution of Profits to Permanent Establishments (the Report), issued in 2008, summarized the OECD s initiative to establish a broad consensus regarding the interpretation and

practical application of Article 7 of the OECD Model Tax Convention on Income and Capital (Article 7). Article 7 sets forth international tax principles for attributing profits to a permanent establishment and forms the basis of an extensive network of bilateral income tax treaties between OECD member countries and between many OECD member and non-member countries. Part IV of the Report addresses the attribution of profits to a permanent establishment of an enterprise that conducts insurance activities. In 2010, a new version of Article 7 and related commentary was adopted to be used in the negotiation of new treaties and amendments to existing treaties. Although provisions of this new version of Article 7 and related commentary have not and are not expected to change materially the manner in which we are taxed, there can be no assurance that future OECD recommendations related to the Report may not have an adverse impact on us.

If an investor acquires 10% or more of our ordinary shares, it may be subject to taxation under the controlled foreign corporation rules.

Under certain circumstances, a U.S. person who owns 10% or more of the voting power of a foreign corporation that is a CFC (a foreign corporation in which 10% U.S. shareholders own more than 50% of the voting power of the foreign corporation or more than 25% of a foreign insurance company) for an uninterrupted period of 30 days or more during a taxable year must include in gross income for U.S. federal income tax purposes such 10% U.S. Shareholder s pro rata share of the CFC s subpart F income, even if the subpart F income is not distributed to such 10% U.S. Shareholder, if such 10% U.S. Shareholder owns (directly or indirectly through foreign entities) any shares of the foreign corporation on the last day of the corporation s taxable year. Subpart F income of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income) attributable to the insurance of risks situated outside the CFC s country of incorporation.

While provisions in our organizational documents serve to limit voting power on our ordinary shares, it is possible, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge, in which case an investor s investment could be materially adversely affected, if the investor is considered to own 10% or more of our shares.

U.S. Persons who hold shares will be subject to adverse tax consequences if we are considered to be a PFIC for U.S. federal income tax purposes.

If we are considered a PFIC for U.S. federal income tax purposes, a U.S. person who owns any of our shares will be subject to adverse tax consequences, including a greater tax liability than might otherwise apply and tax on amounts in advance of when tax would otherwise be imposed, in which case an investor s investment could be materially adversely affected. In addition, if we were considered a PFIC, upon the death of any U.S. individual owning shares, such individual s heirs or estate would not be entitled to a step-up in the basis of the shares that might otherwise be available under U.S. federal income tax laws. We believe that we are not, have not been, and currently do not expect to become, a PFIC for U.S. federal income tax purposes. We cannot provide assurance, however, that we will not be deemed a PFIC by the IRS in the future. If we were considered a PFIC, it could have material adverse tax consequences for an investor that is subject to U.S. federal income taxation. There are currently no regulations regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be forthcoming. We cannot predict what impact, if any, such guidance would have on an investor that is subject to U.S. federal income taxation.

There are U.S. income tax risks associated with the related person insurance income of our non-U.S. insurance subsidiaries.

If (i) the related person insurance income, which we refer to as RPII, of any one of our non-U.S. insurance subsidiaries were to equal or exceed 20% of that subsidiary s gross insurance income in any taxable year and (ii) U.S. persons were treated as owning 25% or more of the subsidiary s stock (by vote or value), a U.S. person who owns any ordinary

shares, directly or indirectly, on the last day of such taxable year on which the 25% threshold is met would be required to include in its income for U.S. federal income tax purposes that person s ratable share of that subsidiary s RPII for the taxable year, determined as if that RPII were distributed proportionately only to U.S. holders at that date, regardless of whether that income is distributed. The amount of RPII earned by a subsidiary (generally premium and related investment income from the direct or indirect insurance or reinsurance of any direct or indirect U.S. holder

of shares of that subsidiary or any person related to that holder) would depend on a number of factors, including the identity of persons directly or indirectly insured or reinsured by that subsidiary. Although we do not believe that the 20% threshold will be met in respect of any of our non-U.S. insurance subsidiaries, some of the factors that may affect the result in any period may be beyond our control. Consequently, we cannot provide absolute assurance that we will not exceed the RPII threshold in any taxable year.

The RPII rules provide that if a holder who is a U.S. person disposes of shares in a non-U.S. insurance corporation that had RPII (even if the 20% gross income threshold was not met) and met the 25% ownership threshold at any time during the five-year period ending on the date of disposition, and the holder owned any stock at such time, any gain from the disposition will generally be treated as a dividend to the extent of the holder s share (taking into account certain rules for determining a U.S. holder s share of RPII) of the corporation s undistributed earnings and profits that were accumulated during the period that the holder owned the shares (possibly whether or not those earnings and profits are attributable to RPII). In addition, such a shareholder will be required to comply with specified reporting requirements, regardless of the amount of shares owned. We believe that these rules should not apply to dispositions of our ordinary shares because XL- Ireland is not itself directly engaged in the insurance business. We cannot provide absolute assurance, however, that the IRS will not successfully assert that these rules apply to dispositions of our ordinary shares.

We and our Bermuda insurance subsidiaries may become subject to taxes in Bermuda in the future, which may have a material adverse effect on our financial condition, results of operations and your investment.

Our Bermuda insurance subsidiaries have received from the Ministry of Finance in Bermuda exemptions from any Bermuda taxes that might be imposed on profits, income or any capital asset, gain or appreciation until March 31, 2035. The exemptions are subject to the proviso that they are not construed so as to prevent the application of any tax or duty to persons who are ordinarily residents in Bermuda (the Company and our Bermuda insurance subsidiaries are not so currently designated) and to prevent the application of any tax payable in accordance with the provisions of The Land Tax Act 1967 or otherwise payable in relation to the land leased to us and our Bermuda insurance subsidiaries. XL-Ireland and other Bermuda-based subsidiaries not incorporated in Bermuda have also received similar exemptions as permit companies under the Companies Act of 1981 of Bermuda. These exemptions are expected to be extended to 2035. Our Bermuda insurance subsidiaries are required to pay certain annual Bermuda government fees and certain business fees as an insurer under The Insurance Act 1978 of Bermuda. Currently there is no Bermuda withholding tax on dividends paid by our Bermuda insurance subsidiaries to us. There can be no assurance that the tax rules as presently applied may not change in the future.

XL-Cayman may become subject to taxes in the Cayman Islands after June 2, 2018, which may have a material adverse effect on our results of operations and your investment.

For tax purposes, XL-Cayman is resident in Ireland by virtue of central management and control. In the event Cayman introduces a corporate income tax based on place of incorporation, XL-Cayman would be a dual resident company and potentially subject to tax in both Ireland and Cayman. As there is no double tax treaty between the Cayman Islands and Ireland, XL-Cayman could become subject to taxation in both Ireland and Cayman. Under current Cayman Islands law, we are not obligated to pay any taxes in the Cayman Islands on our income or gains. We have received an undertaking from the Governor-in-Council of the Cayman Islands pursuant to the provisions of the Tax Concessions Law, as amended, that until June 2, 2018, (i) no subsequently enacted law imposing any tax on profits, income, gains or appreciation shall apply to us and (ii) no such tax and no tax in the nature of an estate duty or an inheritance tax shall be payable on any of our ordinary shares, debentures or other obligations. Given the limited duration of the undertaking from the Governor-in-Council of the Cayman Islands, we cannot be certain that we will not be subject to any Cayman Islands tax after June 2, 2018. Such taxation could have a material adverse effect on our financial condition, results of operations and your investment.

Our tax position could be adversely impacted by changes in tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof.

Our tax position could be adversely impacted by changes in tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof by the tax authorities in Ireland, the United States and other jurisdictions, and such changes may be more likely or become more likely in view of recent economic

trends in such jurisdictions, particularly if such trends continue. For example, Ireland has suffered from the consequences of worldwide adverse economic conditions and the credit ratings on its debt have been downgraded. Such tax law changes could cause a material and adverse change in our worldwide effective tax rate and we may have to take further action, at potentially significant expense, to seek to mitigate the effect of such changes. Any future amendments to the current income tax treaties between Ireland and other jurisdictions, including the United States, could subject us to increased taxation and/or potentially significant expense.

Dividends you receive may be subject to Irish dividend withholding tax and Irish income tax.

Dividend withholding tax (currently at a rate of 20%) may arise in respect of dividends paid on the Company s ordinary shares. However, a number of exemptions from dividend withholding tax exist such that ordinary shareholders resident in the United States and ordinary shareholders resident in other specified countries (listed in Annex F attached to the Redomestication Proxy Statement filed with the SEC on March 10, 2010) may be entitled to exemptions from dividend withholding tax if they complete and file certain dividend withholding tax forms. Ordinary shareholders resident in the U.S. that hold their ordinary shares through the Depository Trust Company (DTC) will not be subject to dividend withholding tax provided the addresses of the beneficial owners of such ordinary shares in the records of the brokers holding such ordinary shares are in the United States (so that such brokers can further transmit the relevant information to a qualifying intermediary appointed by the Company). Similarly, ordinary shareholders resident in the U.S. that hold their ordinary shares directly instead of beneficially through DTC are not subject to dividend withholding tax if such ordinary shareholders held ordinary shares in the Company on January 12, 2010 and they provided a valid Form W-9 showing a U.S. address to the Company s transfer agent. However, other ordinary shareholders may be subject to dividend withholding tax, which could adversely affect the price of our ordinary shares.

In addition, ordinary shareholders entitled to an exemption from Irish dividend withholding tax on dividends received from the Company should not be subject to Irish income tax in respect of those dividends, unless they have some connection with Ireland other than their ordinary shareholdings in the Company. Ordinary shareholders who receive dividends subject to Irish dividend withholding tax will generally have no further liability to Irish income tax on those dividends unless they have some connection with Ireland other than their ordinary shareholding in the Company.

A future transfer of your ordinary shares, other than one effected by means of the transfer of book entry interests in DTC, may be subject to Irish stamp duty.

Transfers of our ordinary shares effected by means of the transfer of book entry interests in DTC will not be subject to Irish stamp duty. The majority of our ordinary shares will be traded through DTC, either directly or through brokers who hold such ordinary shares on behalf of customers through DTC. However, if you hold your ordinary shares directly rather than beneficially through DTC (or through a broker that holds your ordinary shares through DTC), any transfer of your ordinary shares could be subject to Irish stamp duty (currently at the rate of 1% of the higher of the price paid or the market value of the ordinary shares acquired). Payment of Irish stamp duty is generally a legal obligation of the transferee. The potential for stamp duty could adversely affect the price of our ordinary shares.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We operate in Bermuda, the United States, Europe and various other locations around the world. In 1997, we acquired commercial real estate in Hamilton, Bermuda for the purpose of securing long-term office space for our worldwide headquarters. The development was completed in April 2001. The total cost of this development, including land, was approximately $126.6 million. We have subsequently sub-leased portions of this property as a part of our broader expense reduction initiatives.

In July 2003, we acquired new offices at 70 Gracechurch Street, London, which have become our London headquarters. The acquisition was made through a purchase, sale and leaseback transaction. The move to the new offices was completed in 2004 and consolidated our London businesses in one location. The capital lease asset and liability associated with this transaction totaled $98.5 million at December 31, 2012.

In June 2012, we acquired new offices at 8 St. Stephen s Green, Dublin, Ireland as our new global headquarters. The acquisition purchase price was $9.6 million. Completion of the new office and consolidation of our existing Dublin locations are expected in mid-2013.

Each of our reporting segments uses the properties described above. All other office facilities throughout the world that are occupied by us and our subsidiaries are leased.

Total rent expense for the years ended December 31, 2012, 2011 and 2010 was $35.6 million, $32.9 million and $31.8 million, respectively. See Item 8, Note 17(d), Commitments and Contingencies Properties, to the Consolidated Financial Statements included herein, for discussion of our lease commitments for real property.

ITEM 3. LEGAL PROCEEDINGS

We are subject to litigation and arbitration in the normal course of its business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for us and for the property and casualty insurance and reinsurance industry in general. Such claims proceedings are considered in connection with our loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to litigation relating to insurance and reinsurance claims, we are subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on insurance or reinsurance policies. These types of actions typically involve, among other things, allegations of underwriting errors or misconduct, employment disputes, actions brought by or on behalf of shareholders or disputes arising from business ventures. The status of these legal actions is actively monitored by management.

Legal actions are subject to inherent uncertainties, and future events could change management s assessment of the probability or estimated amount of potential losses from pending or threatened legal actions. Based on available information, it is the opinion of management that the ultimate resolution of pending or threatened legal actions other than claims proceedings, both individually and in the aggregate, will not result in losses having a material adverse effect on our financial position or liquidity at December 31, 2012. For further information in relation to legal proceedings, see Item 8, Note 17(g), Commitments and Contingencies Litigation, to the Consolidated Financial Statements included herein.

In August 2005, plaintiffs in a proposed class action (the Class Action) that was consolidated into a multidistrict litigation in the United States District Court for the District of New Jersey, captioned In re Brokerage Antitrust Litigation, MDL No. 1663, Civil Action No. 04-5184 (the MDL), filed a consolidated amended complaint (the Amended Complaint), which named as new defendants approximately 30 entities, including Greenwich Insurance Company, Indian Harbor Insurance Company and XL-Cayman (the XL Defendants). In the MDL, the Class Action plaintiffs asserted various claims purportedly on behalf of a class of commercial insureds against approximately 113 insurance companies and insurance brokers through which the named plaintiffs allegedly purchased insurance. The Amended Complaint alleged that the defendant insurance companies and insurance brokers conspired to manipulate bidding practices for insurance policies in certain insurance lines and failed to disclose certain commission arrangements and asserted statutory claims under the Sherman Act, various state antitrust laws and the Racketeer Influenced and Corrupt Organizations Act (RICO), as well as common law claims alleging breach of fiduciary duty, aiding and abetting a breach of fiduciary duty and unjust enrichment. By Opinion and Order dated August 31, 2007, the District Court dismissed the Sherman Act claims with prejudice and, by Opinion and Order dated September 28, 2007, the District Court dismissed the RICO claims with prejudice. The plaintiffs then appealed both Orders to the U.S. Court of Appeals for the Third Circuit. On August 16, 2010, the Third Circuit affirmed in large part the District Court s dismissal. The Third Circuit reversed the dismissal of certain Sherman Act and RICO claims alleged against

several defendants including the XL Defendants but remanded those claims to the District Court for further consideration of their adequacy. In light of its reversal and remand of certain of the federal claims, the Third Circuit also reversed the District Court s dismissal (based on the District Court s declining to exercise supplemental jurisdiction) of the state-law claims against all defendants. On October 1, 2010, the remaining defendants, including the XL Defendants, filed motions to dismiss the remanded federal claims and the state-law claims. The motions were fully briefed in November 2010. In May 2011, a majority of the remaining defendants, including the XL Defendants, executed a formal Settlement Agreement with the Class Action plaintiffs to settle the Class Action and dismiss all claims with prejudice. The settlement was approved by the District Court by Order

dated March 30, 2012. The XL Defendants portion of the defendants aggregate settlement payment is $6.75 million. Certain objectors filed, but then withdrew, their appeals from the District Court s March 30, 2012 Order approving the settlement.

Various XL entities have been named as defendants in three of the many tag-along actions that were consolidated into the MDL for pretrial purposes. The complaints in these tag-along actions make allegations similar to those made in the Amended Complaint but do not purport to be class actions. On April 4, 2006, a tag-along complaint was filed in the U.S. District Court for the Northern District of Georgia on behalf of New Cingular Wireless Headquarters LLC and several other corporations including Greenwich Insurance Company, XL Specialty Insurance Company, XL Insurance America, Inc., XL Insurance Company Limited and XL- Cayman. On or about May 21, 2007, a tag-along complaint was filed in the U.S. District Court for the District of New Jersey on behalf of Henley Management Company, Big Bear Properties, Inc., Northbrook Properties, Inc., RCK Properties, Inc., Kitchens, Inc., Aberfeldy LP and Payroll and Insurance Group, Inc. against multiple defendants, including XL Winterthur International. On October 12, 2007, a complaint in a third tag-along action was filed in the U.S. District Court for the Northern District of Georgia by Sears, Roebuck & Co., Sears Holdings Corporation, Kmart Corporation and Lands End Inc. against many named defendants including X.L. America, Inc., XL Insurance America, Inc., XL Specialty Insurance Company and XL Insurance (Bermuda) Ltd (XLIB). On October 17, 2011, the District Court lifted the stay of the tag-along actions, including the three in which the XL entities were named as defendants. On April 30, 2012, the District Court set (and subsequently amended) a pre-trial litigation schedule governing the tag-along actions. The parties are currently engaged in discovery, and the defendants have filed various threshold motions directed to plaintiffs complaints. In connection with the settlement mediation ordered by the District Court, the XL defendants reached settlements with the respective plaintiffs in the New Cingular and Henley tag-along actions, and those actions have been dismissed with prejudice. Three XL entities remain as defendants in the Sears tag-along action; XL Insurance America, Inc. and XL Specialty Insurance Company have moved to dismiss the Sears Amended Complaint, while XLIB has moved to compel arbitration of the Sears Plaintiffs claims against it pursuant to the arbitration clauses contained in the XLIB insurance policies purchased by the Sears Plaintiffs.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Executive Officers of the Registrant

The table below sets forth the names, ages and titles of the persons who were the executive officers of the Company at February 25, 2013:

Name	Age	Position
Michael S. McGavick	55	Chief Executive Officer and Director
Susan L. Cross	52	Executive Vice President and Global Chief Actuary
Kirstin Gould	46	Executive Vice President, General Counsel and Secretary
Gregory S. Hendrick	47	Executive Vice President and Chief Executive of Insurance Operations
W. Myron Hendry	64	Executive Vice President and Chief Platform Officer
Peter R. Porrino	56	Executive Vice President and Chief Financial Officer
Jacob D. Rosengarten	57	Executive Vice President and Chief Enterprise Risk Officer

Sarah E. Street	51	Executive Vice President and Chief Investment Officer
James H. Veghte	56	Executive Vice President and Chief Executive of Reinsurance Operations
Eileen Whelley	59	Executive Vice President and Chief Human Resources Officer

Michael S. McGavick, was appointed as Director of the Company in April 2008 and shortly prior to his commencement as the Company s Chief Executive Officer on May 1, 2008. Previously, Mr. McGavick was President & CEO of the Seattle-based Safeco Corporation from January 2001 to December 2005. Prior to joining Safeco, Mr. McGavick spent six years with the Chicago-based CNA Financial Corporation, where he held various senior executive positions before becoming President and Chief Operating Officer of the company s largest commercial insurance operating unit. Mr. McGavick s insurance industry experience also includes two years as Director of the American Insurance Association s Superfund Improvement Project in

Washington D.C., where he became the Association s lead strategist in working to transform U.S. Superfund environmental laws.

Susan L. Cross was appointed to the Company s leadership team in August 2008, serving as Executive Vice President and Global Chief Actuary. Ms. Cross has served as Global Chief Actuary since 2006 and previously was Chief Actuary of the Company s reinsurance operations from 2004 to 2006 and Chief Actuary of XL Re Bermuda from 2002 to 2004. She also held various actuarial positions in the insurance and reinsurance operations of the Company from 1999 to 2002. Prior to joining the Company, Ms. Cross was Principal and Consulting Actuary at Tillinghast Towers Perrin.

Kirstin Gould was appointed Executive Vice President, General Counsel in September 2007, which position includes her prior responsibilities as General Counsel, Corporate Affairs and Corporate Secretary. In 2008, Ms. Gould also assumed leadership of the Communications, Marketing and Public Affairs department. Ms. Gould was previously Executive Vice President, General Counsel, Corporate Affairs from July 2006 to September 2007 and also served as Chief Corporate Legal Officer from November 2004 to July 2006, and Associate General Counsel from July 2001 to November 2004. Prior to joining the Company in 2000, Ms. Gould was associated with the law firms of Clifford Chance and Dewey Ballantine in New York and London.

Gregory S. Hendrick was appointed Executive Vice President and Chief Executive of Insurance Operations in January 2012. From October 2010 to January 2012, Mr. Hendrick served as Executive Vice President, Strategic Growth. From 2004 to October 2010, Mr. Hendrick served as President and Chief Underwriting Officer of XL Re Ltd. Previously, he served as Lead for U.S. Property Treaty underwriting at XL Re Ltd and Vice President responsible for U.S. Property Underwriting for XL Mid Ocean Reinsurance Ltd. Prior to joining XL, Mr. Hendrick was Assistant Vice President of Treaty Underwriting for the Winterthur Reinsurance Corporation of America.

W. Myron Hendry joined the Company s leadership team upon his appointment as Executive Vice President, Chief Platform Officer in December 2009. Prior to joining the Company, from 2006 to December 2009, Mr. Hendry served as Business Operations Executive of Bank of America s Insurance Group, joining there from a merger with Countrywide Insurance Services Group. Prior to the merger, Mr. Hendry served as Managing Director and Chief Operating Officer for Countrywide and prior to this, from 2004 to 2006, Mr. Hendry served as Senior Vice President, Property and Casualty Services at Safeco. From 1971 to 2004, Mr. Hendry held various leadership roles with CNA Insurance, with his last assignment being the Senior Vice President of Worldwide Operations.

Peter R. Porrino was appointed Executive Vice President, Chief Financial Officer in August 2011. Previously, Mr. Porrino served as Ernst & Young s Global Director of Insurance Industry Services from 1999 to August 2011. Mr. Porrino first joined Ernst & Young in 1978 and served in the firm s New York and National insurance practices for 15 years before leaving to serve in senior management positions with several insurance companies. This experience includes Zurich Financial Services, where Mr. Porrino served as CFO of Zurich s NYSE-listed subsidiary, Zurich Reinsurance Centre, Inc. He rejoined Ernst & Young in 1999.

Jacob D. Rosengarten joined the Company s leadership team and was appointed Executive Vice President, Chief Enterprise Risk Officer in September 2008. Prior to joining the Company, Mr. Rosengarten served as Managing Director of Risk Management and Analytics for Goldman Sachs Asset Management from 1998 to 2008. From 1993 to 1997, Mr. Rosengarten served as Director of Risk and Quantitative Analysis at Commodities Corporation and prior to this, from 1983 to 1992 held progressively senior finance positions at Commodities Corporation.

Sarah E. Street was appointed to the position of Executive Vice President and Chief Investment Officer in October 2006. Ms. Street has also served as the Chief Executive Officer of XL Capital Investment Partners Inc. since April 2001. Prior to joining XL in 2001, Ms. Street held numerous leadership positions at JPMorganChase and its predecessor organizations, working in a number of corporate finance units as well as in the capital markets business of the bank.

James H. Veghte was appointed Executive Vice President, Chief Executive of Reinsurance Operations in January 2006. Mr. Veghte had served as the Chief Executive Officer of XL Reinsurance America Inc. (XLRA) since 2004, having previously served as Chief Operating Officer of the Company s reinsurance operations and President, Chief Operating Officer & Chief Underwriting Officer of XL Re Ltd. Additional previously held roles with the Company include President of XL Re Latin America Ltd., Chief Operating

Officer of Le Mans Re (now the French branch of XL Re Europe Ltd.), General Manager of XL Re Ltd s London branch and Executive Vice President and Underwriter of XL Mid Ocean Reinsurance Ltd in Bermuda. Prior to joining XL, Mr. Veghte was Senior Vice President and Chief Underwriting Officer of Winterthur Reinsurance Corporation of America.

Eileen Whelley was appointed to the Company s leadership team in June 2012, serving as Executive Vice President, Chief Human Resources Officer, where she is responsible for global talent acquisition, leadership and professional development, succession planning, compensation and benefit program design and administration, employee relations, organizational effectiveness, performance management, HR information systems and payroll. Prior to joining the Company, from 2006 to 2012, Ms. Whelley served as Executive Vice President, Human Resources, for The Hartford Financial Services Group, Inc. Prior to that, Ms. Whelley spent 17 years at General Electric, where she held a number of human resources leadership roles, including Executive Vice President of Human Resources for NBC Universal and Vice President of Human Resources Excellence for GE Capital. She also served in various HR roles at Citicorp and Standard Oil of Ohio.

Non-Employee Directors of the Registrant

Robert R. Glauber has been the non-executive Chairman of the Board since April 2009 and a director since September 2006, having originally served on our Board from 1998 to May 2005. Mr. Glauber is presently a Lecturer at the Harvard Kennedy School of Government.

Ramani Ayer has been a director since February 2011. Previously, Mr. Ayer served as the Chairman of the board and Chief Executive Officer of The Hartford Financial Services Group Inc., a leading provider of insurance and wealth management services.

Dale Comey has been a director since November 2001. Previously, Mr. Comey was Executive Vice President of ITT Corporation, where he was responsible for directing the operations of several business units, including ITT Hartford and ITT Financial Corporation.

Herbert N. Haag has been a director since June 2006. Previously, Mr. Haag was the founding President and CEO of the Bermuda-based reinsurer PartnerRe Ltd.

Suzanne B. Labarge has been a director since October 2011. Previously Ms. Labarge served as the Vice Chairman and Chief Risk Officer of Royal Bank of Canada (RBC Financial Group), a diversified financial services company.

Joseph Mauriello has been a director since January 2006. Previously, Mr. Mauriello was the Deputy Chairman, Chief Operating Officer and a director of KPMG LLP (United States) and KPMG Americas Region, a leading provider of audit, tax and advisory services.

Eugene M. McQuade has been a director since July 2004. Mr. McQuade currently serves as the CEO and a director of Citibank, N.A., the commercial banking arm of Citigroup, and is a member of Citigroup s Operating Committee.

Clayton S. Rose has been a director since December 2009. Mr. Rose is presently a Professor of Management Practice at the Harvard Business School.

Sir John M. Vereker has been a director since November 2007. Previously, Sir John Vereker was the Governor and Commander-in-Chief of Bermuda.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our ordinary shares, $0.01 par value per share, are listed on the NYSE under the symbol XL.

The following table sets forth the high, low and closing sales prices per share of our ordinary shares per fiscal quarter, as reported on the New York Stock Exchange Composite Tape:

	High	Low	Close
2012:			
1st Quarter	$ 22.03	$ 18.86	$ 21.69
2nd Quarter	$ 22.64	$ 19.52	$ 21.04
3rd Quarter	$ 24.89	$ 19.90	$ 24.03
4th Quarter	$ 25.78	$ 23.15	$ 25.06
2011:			
1st Quarter	$ 24.82	$ 21.17	$ 24.60
2nd Quarter	$ 25.43	$ 20.53	$ 21.98
3rd Quarter	$ 22.65	$ 17.94	$ 18.80
4th Quarter	$ 23.00	$ 17.69	$ 19.77

The number of record holders of ordinary shares at February 25, 2012 was 171. This figure does not represent the actual number of beneficial owners of our ordinary shares because such shares are frequently held in street name by securities dealers and others for the benefit of individual owners who may vote the shares.

In 2012, four quarterly dividends of $0.11 per share were paid to all ordinary shareholders of record as of March 15, June 15, September 14 and December 14. In 2011, four quarterly dividends of $0.11 per share were paid to all ordinary shareholders of record as of March 15, June 15, September 15 and December 15. On February 22, 2013, the XL-Ireland Board of Directors announced a quarterly dividend of $0.14 per share, payable to all ordinary shareholders of record as of March 15, 2013.

The declaration and payment of future dividends will be at the discretion of the XL-Ireland Board of Directors and will depend upon many factors, including our earnings, financial condition, business needs, consideration of other methods of returning capital to shareholders, capital and surplus requirements of our operating subsidiaries and regulatory and contractual restrictions.

As a holding company, our assets consist primarily of investments in subsidiaries. Accordingly, we rely on the availability of dividends and other permissible payments from our subsidiaries to pay ordinary and preferred dividends. Our subsidiaries payment of dividends to us are regulated under the laws of various jurisdictions including Bermuda, the U.K., Ireland, Switzerland, the Society of Lloyd s and certain insurance statutes of various states in the United States in which our principal operating subsidiaries are licensed to transact business and the other jurisdictions where we have regulated subsidiaries. In addition, under Irish law, XL-Ireland may only pay dividends or buyback or redeem shares using distributable reserves. In addition, no dividend or distribution may be made unless the net assets of XL-Ireland are not less than the aggregate of its share capital plus undistributable reserves and the distribution does

not reduce XL-Ireland s net assets below such aggregate. See Item 1, Business Regulation, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements included herein, for further discussion.

The following table summarizes our equity compensation plan information at December 31, 2012:

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	**Weighted Average Exercise Price of Outstanding Options, Warrants and Rights**	**Number of Securities Remaining Available for Future Issuance Under Share-Based Compensation Plans (Excluding Securities in column (a))**
Plan Category	(a)	(b)	(c)
Share-based compensation plans approved by security holders (1)	12,091,017	38.50	15,694,705
Share-based compensation plans not approved by security holders (2)			
Total	12,091,017	38.50	15,694,705

(1) Pertains to our 1991 Performance Incentive Program and the Directors Stock & Option Plan. Includes for the 1991 Performance Incentive Program, 11,813,517 securities to be issued upon exercise of outstanding options, warrants and rights, a

$38.34 weighted average exercise price of outstanding options, warrants and rights, and 15,556,359 securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column a). Includes for the Directors Stock & Option Plan, 277,500 securities to be issued upon exercise of outstanding options, warrants and rights, a $45.34 weighted average exercise price of outstanding options, warrants and rights, and 138,346 securities remaining available for future issuance under equity compensation plans (excluding securities reflected in

column a).

(2) In relation to the 1991 Performance Incentive Program (the Program), of such maximum number of ordinary shares at December 31, 2012, shares can be issued as any form of award, except that, for each restricted stock, restricted stock unit, stock appreciation rights, or performance share award issued, the number of ordinary shares available under the Program will be reduced by two shares. In the event that an award issued under the Program expires or is terminated unexercised as to any shares covered thereby, or shares are forfeited for any reason under the Program, such

shares shall thereafter be again available for issuance under the Program. At the Management Development and Compensation Committee s discretion, these shares may be granted as stock options, performance shares, restricted stock, restricted stock units, stock appreciation rights or any combination of these provided that the combined total number of shares granted does not exceed either the overall share authorization described within the Program for performance shares, stock appreciation rights, restricted stock and restricted stock units.

Purchases of Equity Securities by the Issuer and Affiliate Purchasers

The following table provides information about purchases by us during the quarter ended December 31, 2012 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Value of Shares that May Yet Be Under the Plans or Purchased Programs (1) (2)
October 1, 2012 to October 31, 2012		$		$ 400.0 million
November 1, 2012 to November 30, 2012	2,750	24.59		400.0 million
December 1, 2012 to December 31, 2012	2,085,149	24.78	2,085,149	348.4 million
Total	2,087,899	$ 24.78	2,085,149	$ 348.4 million

(1) Shares purchased in connection with the vesting of restricted shares granted under our restricted stock plan do not represent shares purchased as part of publicly announced plans or programs. All such purchases were made in connection with satisfying tax withholding obligations of those employees. These shares were not

purchased as part of our share buyback program noted below.

(2) On February 27, 2012, we announced that the XL-Ireland Board of Directors approved a share buyback program, authorizing the purchase of up to $750 million of our ordinary shares (the February 2012 Program). This authorization replaced the approximately $190 million remaining under the share buyback program that was authorized in November 2010. During 2012, we purchased and canceled 18.3 million ordinary shares under the February 2012 Program for $401.6 million. At December 31, 2012, $348.4 million remained available for purchase under this program.

Between January 1 and February 22, 2013 we purchased and canceled an additional 3.8 million shares for $98.4 million. All share buybacks were carried out by way of redemption in accordance with Irish law and XL-Ireland s constitutional documents. All shares so redeemed were canceled upon redemption. On February 22, 2013, we announced that the XL-Ireland Board of Directors approved a new share buyback program, authorizing the purchase of up to $850 million of our ordinary shares. This replaced the approximately $250 million remaining under the February 2012 Program.

Ordinary Share Performance Graph

Set forth below is a line graph comparing the yearly dollar change in the cumulative total shareholder return over a five-year period on our ordinary shares from December 31, 2007 through December 31, 2012 as compared to the cumulative total return of the Standard & Poor s 500 Stock Index and the cumulative total return of the Standard & Poor s Property & Casualty Insurance Index. The companies included in these indices or noted as competitors under Item 1, Business, may not be included in our compensation peer group.

The graph shows the value on December 31, 2008, 2009, 2010, 2011 and 2012, of a $100 investment made on December 31, 2007, with all dividends reinvested.

The remaining information required by this Item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which information is incorporated by reference.

ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated financial data below is based upon our fiscal year end of December 31. The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements and the Notes thereto presented under Item 8.

	2012	2011	2010	2009	2008
	(U.S. dollars in thousands, except per share amounts)				
Income Statement Data:					
Net premiums earned	$ 6,090,441	$ 5,690,130	$ 5,414,061	$ 5,706,840	$ 6,640,102
Net investment income	1,012,348	1,137,769	1,198,038	1,319,823	1,768,977
Net realized gains (losses) on investments	14,098	(188,359)	(270,803)	(921,437)	(962,054)
Net realized and unrealized gains (losses) on derivative instruments	5,221	(10,738)	(33,843)	(33,647)	(73,368)
Net income (loss) from investment fund affiliates (1)	58,504	26,253	51,102	78,867	(277,696)
Fee income and other	49,868	41,748	40,027	43,201	52,158
Net losses and loss expenses incurred (2)	3,765,482	4,078,391	3,211,800	3,168,837	3,962,898
Claims and policy benefits life operations	486,198	535,074	513,833	677,562	769,004
Acquisition costs, operating expenses and foreign exchange gains and losses	2,097,989	1,869,688	1,751,060	1,996,052	1,924,908
Interest expense	172,205	205,592	213,643	216,504	351,800
			23,500		

Loss on settlement of guarantee					
Extinguishment of debt					22,527
Impairment of goodwill		429,020			989,971
Income (loss) before non-controlling interests, net income from operating affiliates and income tax expense	708,606	(420,962)	684,746	134,714	(872,989)
Income (loss) from operating affiliates (1)(2)	55,810	76,786	121,372	60,480	(1,458,246)
Preference share dividends (3)			74,521	80,200	78,645
Net income (loss) attributable to ordinary shareholders	651,134	(474,760)	585,472	206,607	(2,632,458)

	2012	2011	2010	2009	2
		(U.S. dollars in thousands, except per share amounts)			
Per Share Data:					
Earnings (loss) per ordinary share and ordinary share equivalent basic (4)(5)	$ 2.12	$ (1.52)	$ 1.74	$ 0.61	$
Earnings (loss) per ordinary share and ordinary share equivalent diluted (4)(5)	$ 2.10	$ (1.52)	$ 1.73	$ 0.61	$
Weighted average ordinary shares and ordinary share equivalents outstanding diluted (4)	310,282	312,896	337,709	340,966	
Cash dividends per ordinary share	$ 0.44	$ 0.44	$ 0.40	$ 0.40	$
Balance Sheet Data:					
Total investments available for sale (AFS)	$ 28,818,982	$ 27,017,285	$ 27,677,553	$ 29,307,171	$ 27
Total investments held to maturity (HTM)	2,814,447	2,668,978	2,728,335	546,067	
Cash and cash equivalents	2,618,378	3,825,125	3,022,868	3,643,697	4

Investments in affiliates	1,126,875	1,052,729	1,127,181	1,185,604	1
Unpaid losses and loss expenses recoverable	3,382,101	3,654,948	3,671,887	3,584,028	3
Premiums receivable	2,568,861	2,411,611	2,414,912	2,597,602	3
Total assets	45,387,779	44,665,265	44,995,040	45,663,894	45
Unpaid losses and loss expenses	20,484,121	20,613,901	20,531,607	20,823,524	21
Future policy benefit reserves	4,812,045	4,845,394	5,075,127	5,490,119	5
Unearned premiums	3,755,920	3,555,310	3,484,830	3,651,310	4
Notes payable and debt	1,672,778	2,275,327	2,457,003	2,451,417	3
Shareholders equity	11,856,397	10,756,130	10,599,769	9,432,417	6
Fully diluted tangible book value per ordinary share	$ 33.35	$ 28.31	$ 27.14	$ 22.13	$
Operating Ratios:					
Loss and loss expense ratio (6)	65.3 %	76.6 %	63.8 %	61.5 %	
Underwriting expense ratio (7)	31.0 %	30.9 %	31.0 %	32.1 %	
Combined ratio (8)	96.3 %	107.5 %	94.8 %	93.6 %	

(1) We generally record the income related to alternative fund

affiliates on a one-month lag and the private investment fund affiliates on a three-month lag in order for us to meet the filing deadlines for its periodic reports. We generally record the income related to operating affiliates on a three-month lag.

(2) In 2008, net loss from operating affiliates includes losses totaling approximately $1.4 billion related to the closing of the Master Agreement as well as losses recorded throughout 2008 and up until the closing of the Master Agreement that were associated with previous reinsurance and guarantee agreements with Syncora. In 2010, net income from operating affiliates included $50.2 million relating to sale of a majority of our shareholding in Primus Guaranty Ltd.

(3)

Preference dividends represent dividends on the Redeemable Series C preference ordinary shares and the Series D and E preference ordinary shares. Following our Redomestication, subsequent to July 1, 2010, the Redeemable Series C preference ordinary shares and the Series E preference ordinary shares represent non-controlling interests in our consolidated financial statements. For additional information see Item 8, Note 1, "General," to the Consolidated Financial Statements.

(4) Effective for the fiscal year beginning January 1, 2009 and for all interim periods within 2009, we adopted final authoritative guidance that addresses whether instruments granted in share-based payment transactions are

participating
securities prior to
vesting and,
therefore, need to
be included in the
earnings
allocation in
computing basic
earnings per share
(EPS) pursuant to
the two-class
method described
in EPS guidance.
A share-based
payment award
that contains a
non-forfeitable
right to receive
cash when
dividends are
paid to ordinary
shareholders
irrespective of
whether that
award ultimately
vests is
considered a
participating
security as these
rights to
dividends provide
a non-contingent
transfer of value
to the holder of
the share-based
payment award.
Accordingly,
these awards are
included in the
computation of
basic EPS
pursuant to the
two-class method.
Under the terms
of our restricted
stock awards,
grantees are
entitled to receive
dividends on the
unvested portions
of their awards.

There is no requirement to return these dividends in the event the unvested awards are forfeited in the future. Accordingly, this guidance had an impact on our EPS calculations. All prior period EPS data presented has been adjusted retrospectively to conform to the provisions of this guidance. The adoption of this guidance reduced basic loss per ordinary share for fiscal 2008 by $0.08 and reduced diluted loss per ordinary share for fiscal 2008.

(5) Effective April 1, 2009, we adopted final authoritative guidance that addressed the treatment of credit losses on investments. This guidance was not applied retroactively.

(6) The loss and loss expense ratio related to the property and casualty operations is calculated by dividing the losses and loss expenses incurred by the net premiums earned for the Insurance and Reinsurance segments.

(7) The underwriting expense ratio related to the property and casualty operations is the sum of acquisition expenses and operating expenses for the Insurance and Reinsurance segments divided by net premiums earned for the Insurance and Reinsurance segments. See Item 8, Note 4, Segment Information, to the Consolidated Financial Statements included

herein, for further information.

(8) The combined ratio related to the property and casualty operations is the sum of the loss and loss expense ratio and the underwriting expense ratio. A combined ratio under 100% represents an underwriting profit and over 100% represents an underwriting loss.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements which involve inherent risks and uncertainties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based upon current plans, estimates and expectations. Actual results may differ materially from those projected in such forward-looking statements, and therefore undue reliance should not be placed on them. See Cautionary Note Regarding Forward-Looking Statements, for a list of additional factors that could cause actual results to differ materially from those contained in any forward-looking statement.

This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto presented under Item 8.

Certain aspects of our business have loss experience characterized as low frequency and high severity. This may result in volatility in both our results of operations and financial condition.

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Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 (PSLRA) provides a safe harbor for forward-looking statements. Any prospectus, prospectus supplement, Annual Report to ordinary shareholders, proxy statement, Form 10-K, Form 10-Q or Form 8-K or any other written or oral statements made by us or on our behalf may include forward-looking statements that reflect our current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to us in general, and to the insurance and reinsurance sectors in particular (both as to underwriting and investment matters). Statements that include the words expect, intend, plan, believe, project, anticipate, will, may and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the PSLRA or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. We believe that these factors include, but are not limited to, the following:

- changes in the size of our claims relating to natural or man-made catastrophe losses due to the preliminary nature of some reports and estimates of loss and damage to date;
- trends in rates for property and casualty insurance and reinsurance;
- the timely and full recoverability of reinsurance placed by us with third parties, or other amounts due to us;
- changes in ratings or rating agency policies or practices;
- changes in the projected amount of ceded reinsurance recoverables and the ratings and creditworthiness of reinsurers;
- the timing of claims payments being faster

or the receipt of reinsurance recoverables being slower than we anticipated;

our ability to successfully implement our business strategy;

increased competition on the basis of pricing, capacity, coverage terms or other factors, which could harm our ability to maintain or increase our business volumes or profitability;

greater frequency or severity of claims and loss activity than our underwriting, reserving or investment practices anticipate based on historical experience or industry data;

changes in general economic conditions, including the effects of inflation on our business, including on pricing and reserving, and changes in interest rates, credit spreads, foreign currency exchange rates and future volatility in the world s credit, financial and capital markets that adversely affect the performance and valuation of our investments or access to such markets;

developments, including uncertainties related to the future of the Euro-zone, the ability of Euro-zone countries to service existing debt obligations and the strength of the Euro as a currency and to the financial condition of counterparties, reinsurers and other companies that are at risk of bankruptcy;

the potential impact on us from government-mandated insurance coverage for acts of terrorism;

the potential for changes to methodologies, estimations and assumptions that underlie the valuation of our financial instruments that could result in changes to investment valuations;

changes to our assessment as to whether it is more likely than not that we will be required to sell, or have the intent to sell, available for sale debt securities before their anticipated recovery;

the availability of borrowings and letters of credit under our credit facilities;

the ability of our subsidiaries to pay

dividends to XL-Ireland and XL-Cayman;

the potential effect of regulatory developments in the jurisdictions in which we operate, including those which could impact the financial markets or increase our business costs and required capital levels;

changes in regulations or laws applicable to XL-Ireland or our subsidiaries, brokers or customers;

acceptance of our products and services, including new products and services;

changes in the availability, cost or quality of reinsurance;

changes in the distribution or placement of risks due to increased consolidation of insurance and reinsurance brokers;

loss of key personnel;

changes in accounting policies or practices or the application thereof;

legislative or regulatory developments including, but not limited to, changes in regulatory capital balances that must be maintained by our operating subsidiaries and governmental actions for the purpose of stabilizing the financial markets;

the effects of mergers, acquisitions and divestitures;

developments related to bankruptcies of companies insofar as they affect property and casualty insurance and

reinsurance coverages or claims that we may have as a counterparty;

changes in applicable tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof;

the effects of business disruption or economic contraction due to war, terrorism or other hostilities;

our ability to realize the expected benefits from the Redomestication; and

the other factors set forth in Item 1A, Risk Factors, and our other documents on file with the SEC.

The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. We undertake no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by the federal securities laws.

Executive Overview

Background

We are, through our subsidiaries, a global insurance and reinsurance company providing property, casualty and specialty products to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. We operate in markets where we believe our underwriting expertise and financial strength represent a relative advantage. We earn revenue primarily from net premiums written and earned. For further information regarding our operations, see Item 1, Business.

Impact of Recent Natural Catastrophes

In both 2011 and 2012, the global insurance and reinsurance markets experienced significant losses from natural catastrophes. See Significant Items Affecting Results of Operations 1) The impact of significant large loss events below for a discussion of our loss estimates for the year ended December 31, 2012 from natural catastrophes.

Underwriting Environment and Outlook for 2013

The property and casualty insurance and reinsurance markets have historically been cyclical, meaning that based on market conditions, there have been periods where premium rates are high and policy terms and conditions are more favorable to us (a hard market) and there have been periods where premium rates decline and policy terms and conditions are less favorable (a soft market). Market conditions are driven primarily by competition in the marketplace, the supply of capital in the industry, investment yields and the frequency and severity of loss events. Our goal is to build long-term shareholder value by capitalizing on current opportunities and managing through any cyclical downturns by reducing our property and casualty book of business and exposures if and when rates deteriorate during soft market periods.

In 2012, we continued to focus on strategic growth initiatives, building on the significant investments we have made in recent years to achieve greater efficiency from improved systems, to create a platform from which we can grow as markets allow and to expand our margins. The following outlines some of these growth initiatives as well as recent renewal activity and January 2013 rate indications for each of our Insurance and Reinsurance segments together with any potential trends relevant to our P&C operations.

Insurance

The trading environment for the core lines of insurance business that we write remains competitive. However, the favorable pricing trends that we began seeing in late 2011 have continued throughout 2012. While we continue our disciplined underwriting approach to grow on a very selective basis and exit lines where margins are unacceptable, our retention ratios and new business development continue to remain strong as we move premium rates upward in nearly all of our businesses.

We continue to develop new business opportunities in several areas, including our North American construction and surety businesses, which were announced in 2010, and our political risk and trade credit, and North America inland marine businesses, which were announced during the fourth quarter of 2011. We also continue to expand existing businesses such as adding property, excess auto and excess liability to our excess & surplus business and expanding local underwriting in our North America excess casualty business by adding underwriters in Dallas, Atlanta and Exton, PA. Geographic expansion also continues with the opening of an office in China in April 2011 and an office in Brazil in June of 2012 complementing the Reinsurance operation with an Insurance segment branch offering Casualty, Property, Professional and Specialty products.

With regard to market conditions, within the Insurance segment s core lines of business, fourth quarter and full year 2012 renewals reflected sustainable rate increases both in aggregate and across nearly all business lines. For the full year, we experienced positive pricing of over 3%, and in our North America P&C business unit the increase was more than 6%. Professional pricing was also positive for the year where there was material improvement in the U.S. D&O book where rate increases exceeded 5% during the fourth quarter and nearly 4% for the full the year. International P&C and Specialty also finished the year with positive rate increases in the low single digits, with a very strong fourth quarter for IPC, but a flat quarter for Specialty due to the competitive December airline renewals.

We continue to focus on those lines of business that we believe provide the best return on capital, including the writing of selective new business and remaining committed to the underwriting actions necessary to improve our margins. For 2013, initial indications are consistent with current market conditions described above.

Reinsurance

As noted above, the pricing environment on the primary side is showing rate growth but both the primary and reinsurance markets remain highly competitive with substantial capacity available in both traditional and non-traditional forms. In general, January 1 renewals saw pricing in line with management s expectations, with positive pricing across the loss impacted catastrophe books of business and certain specialty lines, while casualty lines remained highly competitive.

In property catastrophe lines we saw loss impacted programs from Storm Sandy experience 10 to 15% rate increases while renewal rates for non-loss impacted U.S. programs were flat. In Europe, with the exception of Italy where we saw double digit increases as a result of the earthquake, prices decreased in the 3 to 5% range. For specialty lines, there were significant price increases in the marine lines due to Storm Sandy, which was the latest in a series of significant losses into that market, while rates in the aviation lines were flat to down 5% due to continued good experience. The casualty markets in both the U.S. and International still remain highly competitive. We saw certain ceding companies increasing their retention levels, a pattern we have seen repeatedly in recent years, while reinsurers that tried to increase their line size at renewal, did so with limited success.

The Reinsurance segment continues to develop new business opportunities in several areas and in 2013, we expect to continue to build upon the strategic growth achieved in recent years and will utilize our broad market relationships and experience to seek opportunities to achieve this.

There can be no assurance, however, that such (re)insurance rate conditions or growth opportunities will be sustained or further materialize, or lead to improvements in our books of business. See Cautionary Note Regarding Forward-Looking Statements.

Investment Environment

We seek to generate book value growth and investment income from investment activities through the total returns on our investment portfolio. During the year ended December 31, 2012, credit spreads tightened and interest rates declined in the majority of the currencies in which we hold assets. Net investment income yields were negatively impacted by lower interest rates and spreads, which in turn reduced prevailing yields on reinvestment income. Net realized gains resulted from sales transactions primarily from a repositioning of the Agency RMBS portfolio and sales of equity and non-U.S. Sovereign Government securities. The impact of tightening credit spreads and decreasing interest rates during 2012 was the primary reason for the improvement in the net unrealized position on fixed maturities and short-term investments over the course of the year. For further information, see Investment Activities below.

Results of Operations and Key Financial Measures

Results of Operations

The following table presents an analysis of our net income (loss) attributable to ordinary shareholders and other financial measures (described below) for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands, except share and per share amounts)		**2012**		**2011**		**2010**
Net income (loss) attributable to ordinary shareholders	$	651,134	$	(474,760)	$	585,472
Earnings (loss) per ordinary share basic	$	2.12	$	(1.52)	$	1.74
Earnings (loss) per ordinary share diluted	$	2.10	$	(1.52)	$	1.73
Weighted average number of ordinary shares and ordinary share equivalents basic		307,372		312,896		336,283
Weighted average number of ordinary shares and ordinary share equivalents diluted		310,282		312,896		337,709

Key Financial Measures

The following are some of the financial measures management considers important in evaluating our operating performance:

(U.S. dollars in thousands, except ratios)		**2012**		**2011**		**2010**
Underwriting profit (loss) P&C operations	$	216,138	$	(397,353)	$	262,494
Combined ratio P&C operations		96.3 %		107.5 %		94.8 %
Net investment income P&C operations	$	712,906	$	819,708	$	884,866
Operating net income	$	614,102	$	89,464	$	809,650
Operating net income per share	$	1.98	$	0.28	$	2.40
Return on average ordinary shareholders equity		6.5 %		(5.0)%		6.5 %
Operating return on average ordinary shareholders equity		6.2 %		0.9 %		9.0 %
Book value per ordinary share	$	35.18	$	29.81	$	30.33
Fully diluted tangible book value per ordinary share	$	33.35	$	28.31	$	27.14

The following are descriptions of these key financial measures and a brief discussion of the factors influencing them:

Underwriting profit property and casualty (P&C) operations

One way that we evaluate the performance of our insurance and reinsurance operations is by underwriting profit or loss. We do not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned less net losses incurred and expenses related to underwriting activities. Our underwriting profit (loss) in the year ended December 31, 2012 was consistent with the combined ratio discussed below.

Combined ratio P&C operations

In the P&C industry, the combined ratio is a widely used measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net

premiums earned for our insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss.

Our combined ratio of 96.3% for the year ended December 31, 2012 was lower than the 107.5% combined ratio in 2011, primarily due to a decrease in the loss and loss expense ratio while the underwriting expense ratio was flat. The loss and loss expense ratio, which is the ratio of losses and loss expenses incurred to net premiums earned, has decreased as a result of lower levels of catastrophe losses and other large loss events as compared to 2011. The underwriting expense ratio, which was flat year on year, is the ratio of the sum of acquisition costs and operating expenses to the net premiums earned.

Our combined ratio of 107.5% for the year ended December 31, 2011 was higher than the 94.8% combined ratio in 2010, primarily as a result of an increase in the loss and loss expense ratio while the underwriting expense ratio was flat. The loss and loss expense ratio increased in 2011 as a result of higher levels of catastrophe losses and other large loss events in both the insurance and reinsurance segments. For further information on our combined ratio, see Income Statement Analysis below.

Net investment income P&C operations

Net investment income related to P&C operations, which includes interest and dividend income together with the amortization of premium and discount on fixed maturities and short-term investments, net of related investment expenses, is an important measure that affects our overall profitability. Our largest liability relates to our unpaid loss reserves, and our investment portfolio provides liquidity for claims settlements of these reserves as they become due. As a result, a significant part of the investment portfolio is invested in fixed income securities. Net investment income is influenced by a number of factors, including the amounts and timing of inward and outward cash flows, the level of interest rates and credit spreads and changes in overall asset allocation. See the segment results at Investment Activities below for a discussion of our net investment income for the year ended December 31, 2012.

Operating net income and Operating net income per share

Operating net income is a non-GAAP financial measure defined as net income (loss) attributable to ordinary shareholders excluding: (1) our net realized gains and losses on investments, net of tax, (2) our net realized and unrealized gains and losses on derivatives, net of tax, (3) our share of items (1) and (2) for our insurance company affiliates for the periods presented, (4) goodwill impairment charges, net of tax, (5) the gains recognized on our repurchase of XL-Cayman s preference ordinary shares and (6) foreign exchange gains or losses, net of tax. We evaluate the performance of and manage our business to produce an underwriting profit. In addition to presenting net income (loss), we believe that showing operating net income (loss) enables investors and other users of our financial information to analyze our performance in a manner similar to how we analyze performance. In this regard, we believe that providing only a GAAP presentation of net income (loss) makes it more difficult for users of our financial information to evaluate our underlying business. We also believe that the equity analysts and certain rating agencies that follow us (and the insurance industry as a whole) exclude these items from their analyses for the same reasons and they request that we provide this non-GAAP financial information on a regular basis. A reconciliation of our net income (loss) attributable to ordinary shareholders to operating net income (loss) is provided at the end of Key Financial Measures below.

Operating net income per share is derived from the non-GAAP operating net income measure by dividing operating net income by the weighted average number of ordinary shares and ordinary share equivalents outstanding for each period.

Return on average ordinary shareholders equity (ROE)

ROE is another non-GAAP financial measure that we consider important in evaluating our operating performance and view as a key measure of return generated for ordinary shareholders. ROE is calculated by dividing the net income (loss) attributable to ordinary shareholders for any period by the average of the opening and closing ordinary shareholders equity. We establish minimum target ROEs for our total operations, segments and lines of business. If our minimum ROE targets over the longer term are not met with respect to any line of business, we seek to modify and/or exit this line. In addition, among other

factors, compensation of our senior officers is dependent on the achievement of our performance goals to enhance ordinary shareholder value as measured by ROE (adjusted for certain items considered to be non-operating in nature).

In 2012, ROE was 6.5%, which was 11.5 percentage points higher than 2011 when it was negative 5.0%. In 2011, ROE was negative due to the net loss from the significant catastrophe losses and the impairment of goodwill and other large loss events which are discussed under Significant Items Affecting the Results of Operations.

Operating return on average ordinary shareholders equity (Operating ROE)

Operating ROE is another non-GAAP financial measure that we consider important in evaluating our operating performance. Operating ROE is derived from the non-GAAP operating net income measure by dividing the operating net income for any period by the average of the opening and closing ordinary shareholders equity.

In 2012, Operating ROE was 6.2%, which was 5.3 percentage points higher than 2011 when it was 0.9%. This was the result of the lower operating net income in 2011 due to the significant catastrophe losses and other large loss events, both discussed under Significant Items Affecting the Results of Operations. A reconciliation of Net income (loss) attributable to ordinary shareholders to operating net income (loss) is provided at Reconciliation of Non-GAAP Measures included herein.

Book value per ordinary share

We view the change in our book value per ordinary share as an additional measure of our performance, representing the value generated for our ordinary shareholders each period, and we believe that this measure (along with the diluted measures described below) is a key driver of our share price over time. Book value per ordinary share, a non-GAAP financial measure, is calculated by dividing ordinary shareholders equity (total shareholders equity less non-controlling interest in equity of consolidated subsidiaries) by the number of outstanding ordinary shares at the applicable period end. Book value per ordinary share is affected primarily by net income (loss), by any changes in the net unrealized gains and losses on our investment portfolio, by currency translation adjustments and by the impact of any share buyback or issuance activity. Ordinary shareholders equity was $10.5 billion and $9.4 billion and the number of ordinary shares outstanding was 298.7 million and 315.7 million at December 31, 2012 and 2011, respectively. Ordinary shares outstanding include all ordinary shares legally issued and outstanding (as disclosed on the face of the balance sheet) as well as all director share units outstanding.

Book value per ordinary share increased by $5.37 in 2012 as compared to a decrease of $0.52 during 2011. The increase in 2012 was primarily due the net income attributable to ordinary shareholders, an increase in net unrealized gains on investments and the benefit of share buyback activity.

The decrease in 2011 was primarily due to the net loss attributable to ordinary shareholders of $474.8 million and the impact of the settlement of the forward purchase contracts associated with the 10.75% equity security units (the 10.75% Units), which resulted in the issuance of an aggregate of 30,456,600 ordinary shares, partially offset by an increase in net unrealized gains on available for sale investments and the benefit of share buyback activity.

Fully diluted tangible book value per ordinary share

Fully diluted tangible book value per ordinary share is a non-GAAP financial measure and is calculated by dividing ordinary shareholders equity excluding intangible assets (as disclosed on the face of the balance sheet) by the number of outstanding ordinary shares at any period end combined with the impact from dilution of share-based compensation and certain conversion features where dilutive. Fully diluted tangible book value per ordinary share increased by $5.04 and $1.17 during the years ended December 31, 2012 and 2011, respectively, as a result of the factors noted above.

Reconciliation of Non-GAAP Measures

The following is a reconciliation of net income (loss) attributable to ordinary shareholders to operating net income (loss) and also includes the calculation of return on average ordinary shareholders equity (based on operating net income (loss)) for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands, except percentages)	2012	2011	2010
Net income (loss) attributable to ordinary shareholders	$ 651,134	$ (474,760)	$ 585,472
Impairment of goodwill, net of tax		417,566	
Net realized losses (gains) on investments, net of tax	(38,235)	178,432	270,803
Net realized and unrealized losses (gains) on derivatives, net of tax	(5,216)	3,914	29,932
Net realized and unrealized losses (gains) on investments and derivatives related to the Company s insurance company affiliates	(301)	(322)	(52,623)
Foreign exchange (gains) losses, net of tax	6,720	(34,016)	(7,318)
Gain on repurchase of non-controlling interest preference ordinary shares		(1,350)	(16,616)
Operating net income (loss):	**$ 614,102**	**$ 89,464**	**$ 809,650**
Per ordinary share results:			
Net income (loss) attributable to ordinary shareholders	$ 2.10	$ (1.52)	$ 1.73
Operating net income (loss)	$ 1.98	$ 0.28	$ 2.40
Weighted average ordinary shares outstanding:			
Basic	307,371,726	312,896,165	336,282,630
Diluted Net income	310,282,466	312,896,165	337,708,643
Diluted Operating net income	310,282,466	316,318,339	337,708,643
Operating return on average ordinary shareholders equity:			
Closing ordinary shareholders equity	$ 10,510,072	$ 9,411,658	$ 9,597,473
Average ordinary shareholders equity	$ 9,960,865	$ 9,504,565	$ 9,007,152
Operating net income (loss)	$ 614,102	$ 89,464	$ 809,650
Operating ROE	**6.2 %**	**0.9 %**	**9.0 %**

Significant Items Affecting the Results of Operations

Our net income and other financial measures as shown above for the year ended December 31, 2012 have been affected by, among other things, the following significant items:

1) The impact of significant large loss events;

2) Continuing competitive factors impacting the underwriting environment;

3) Net favorable prior year loss development; and

4) Market movement impacts on our investment portfolio.

1) The impact of significant large loss events

Natural Catastrophe Losses

The following table outlines the underwriting losses and loss ratio impact for the Insurance and Reinsurance segments from natural catastrophes for the years ended December 31:

(U.S. dollars in thousands, except ratios)	Natural Catastrophe Underwriting Losses			Natural Catastrophe Loss Ratio Impact		
	2012	**2011**	**2010**	**2012**	**2011**	**2010**
Insurance	$ 223,148	$ 355,256	$ 135,771	5.5 %	9.6 %	3.8 %
Reinsurance	241,169	405,870	158,574	13.8 %	25.2 %	10.6 %
Total P&C	$ 464,317	$ 761,126	$ 294,345	8.2 %	14.4 %	5.8 %

Notable natural catastrophes during 2012 included Storm Sandy (Sandy), U.S. tornadoes and the large earthquake in Italy.

Notable natural catastrophes during 2011 included the March 11, 2011 earthquake and tsunami in Japan, the earthquake that struck Christchurch, New Zealand on February 22, 2011, the 2011 flooding events in Australia, the severe weather occurrences, including tornado activity, in the United States during April and May 2011, the Atlantic Hurricanes (Hurricane Irene and Tropical Storm Lee) and the Thailand floods.

Notable natural catastrophes during 2010 included the Chilean Earthquake, European Windstorm Xynthia, U.S. tornadoes and hailstorm activity, the New Zealand Earthquake and floods in Central Europe, China, Poland and Queensland, Australia.

Our loss estimates are based on combinations of our review of individual treaties and policies expected to be impacted, commercial model outputs, client data received to the date the estimates are made, and consideration of expectations of total insured market loss estimates if available, both from published sources and our internal analysis. Our loss estimates involve the exercise of considerable judgment due to the complexity and scale of the insured events, and are, accordingly, subject to revision as additional information becomes available. Actual losses may differ materially from these preliminary estimates.

The following are analyses of the financial impact on our results of operations for the year ended December 31, 2012 from natural catastrophes:

(U.S. dollars in thousands, except ratios)	2012 **Insurance**	**Reinsurance**	**Total**
Operating data:			
Catastrophe reinstatement premium earned:			
Sandy	$ (11,813)	$ 25,560	$ 13,747
Other natural catastrophes (1) (2)	(958)	3,503	2,545
Total net premiums earned	$ (12,771)	$ 29,063	$ 16,292
Gross losses and loss expenses:			
Sandy	$ (207,106)	$ (242,622)	$ (449,728)
Other natural catastrophes (1) (2)	(89,528)	(41,352)	(130,880)
Total gross losses and loss expenses	$ (296,634)	$ (283,974)	$ (580,608)
Losses and loss expenses recoverable:			
Sandy	$ 68,379	$ 12,305	$ 80,684
Other natural catastrophes (1) (2)	17,878	1,437	19,315
Total losses and loss expenses recoverable	$ 86,257	$ 13,742	$ 99,999
Underwriting loss P&C Operations:			

Sandy	$ (150,540)	$ (204,757)	$ (355,297)
Other natural catastrophes (1) (2)	(72,608)	(36,412)	(109,020)
Total underwriting loss	$ (223,148)	$ (241,169)	$ (464,317)
Loss ratio impact for year ended December 31, 2012	5.5 %	13.8 %	8.2 %

(1) For the Insurance segment, for the year ended December 31, 2012, Other natural catastrophes include Italy snow storm, U.S.Tornadoes, Italy earthquake, Hurricane Isaac, Costa Rica Earthquake and New South Wales floods.

(2) For the Reinsurance segment for the year ended December 31, 2012, Other natural catastrophes include U.S.Tornadoes, Italy earthquake, Hurricane Isaac, and Calgary hailstorm.

For further details see the segment results in the Income Statement Analysis below.

Large Non-Catastrophe Loss Events

In the year ended December 31, 2012, our results from operations were impacted by significant losses from large non-catastrophe loss events in both the Insurance and Reinsurance segments. In 2012, the impact was mainly related to a single large marine loss during the first quarter. Management s loss estimate for this large marine loss at December 31, 2012, net of reinsurance recoveries and reinstatement premiums, was $58.5 million, of which $26.4 million was attributable to the Insurance segment and $32.1 million to the

Reinsurance segment. In addition, the results from operations during the year ended December 31, 2012 were affected by crop losses attributable to the severe drought conditions in the United States in 2012. Our preliminary loss estimate for these drought and crop losses net of reinsurance recoveries and reinstatement premiums was $30.8 million, all attributable to the Reinsurance segment.

See Income Statement Analysis, herein for further information regarding these large loss events within each applicable operating segment.

2) Continuing competitive factors impacting the underwriting environment

Soft market conditions were experienced across most lines of business throughout 2010, 2011 and 2012. This resulted in an overall decrease in gross and net premiums written in 2010 but these amounts increased in 2011 and 2012 due to new strategic initiatives and certain rate improvements. For further information in relation to the underwriting environment, including details relating to rates and retention, see Executive Overview Underwriting Environment and Outlook for 2013, above.

3) Net favorable prior year loss development

Net favorable prior year loss development occurs when there is a decrease to loss reserves recorded at the beginning of the year, resulting from actual or reported loss development for prior years that is less than expected. Net prior year adverse loss development occurs when there is an increase to loss reserves recorded at the beginning of the year, resulting from actual or reported loss development for prior years exceeding expected loss development.

The following table presents the net (favorable) adverse prior year loss development of our loss and loss expense reserves for our property and casualty operations, which include the Insurance and Reinsurance segments for each of the years indicated:

(U.S. dollars in thousands)	**2012**	**2011**	**2010**
Insurance	$ (140,067)	$ (76,516)	$ (127,411)
Reinsurance	(175,828)	(208,351)	(245,451)
Total	$ (315,895)	$ (284,867)	$ (372,862)

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 10, Losses and Loss Expenses, to the Consolidated Financial Statements included herein, for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of our operating segments.

4) Market movement impacts on the Company s investment portfolio

During the year ended December 31, 2012, credit spreads tightened and interest rates declined in the majority of the currencies in which we hold assets. The net impact of the market conditions on our investment portfolio was favorable and resulted in a positive mark to market change of $942.7 million on available for sale investments. This represents an approximately 2.1% appreciation in average assets for the year ended December 31, 2012.

The following table provides further detail regarding the movements in relevant credit markets, as well as in government interest rates using selected market indices:

	Interest Rate Movement for the year ended December 31, 2012 (1) (+ / - represents increases / decreases in interest rates)	**Credit Spread Movement for the year ended December 31, 2012 (2) (+ / - represents widening / tightening of credit spreads)**
United States	-11 basis points (5 year Treasury)	-104 basis points (US Corporate A rated) -35 basis points (US Mortgage Master Index) -120 basis points (US CMBS, AAA rated)
United Kingdom	-15 basis points (10 year Gilt)	-72 basis points (UK Corporate, AA rated)
Euro-zone	-46 basis points (5 year Bund)	-170 basis points (Europe Corporate, A rated)

(1) Source: Bloomberg Finance L.P.

(2) Source: Merrill Lynch Global Indices.

Net realized gains on investments in the year ended December 31, 2012 totaled $14.1 million, including $94.8 million from sales activities partially offset by net realized losses of approximately $80.7 million related to other-than-temporary declines in investment (OTTI) charges on certain of our fixed income investments. For further analysis of this, see Results of Operations below.

Other Key Focuses of Management

We remain focused on, among other things, managing capital, enhancing enterprise risk management capabilities and monitoring regulatory change. Details of these initiatives are outlined below.

Capital Management

Fundamental to supporting our business model is our ability to underwrite business, which is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that we are downgraded, our ability to write business, as well as our financial condition and/or results of operations, could be adversely affected.

Buybacks of Ordinary Shares

On February 27, 2012, we announced that the XL-Ireland Board of Directors approved the February 2012 Program, authorizing the purchase of up to $750 million of our ordinary shares. This authorization replaced the approximately $190 million remaining under the share buyback program that was authorized in November 2010. During 2012, we purchased and canceled 18.3 million ordinary shares under the February 2012 Program for $401.6 million. At December 31, 2012, $348.4 million remained available for purchase under this program. Between January 1 and February 22, 2013 we purchased and canceled an additional 3.8 million shares for $98.4 million. All share buybacks were carried out by way of redemption in accordance with Irish law and XL-Ireland s constitutional documents. All shares so redeemed were canceled upon redemption. On February 22, 2013, we announced that the XL-Ireland Board of Directors approved a new share buyback program, authorizing the purchase of up to $850 million of our ordinary shares. This replaced the approximately $250 million remaining under the February 2012 Program.

Repayment of the 6.5% Guaranteed Senior Notes due January 2012 (the XLCFE Notes)

On January 15, 2012, the $600 million principal amount outstanding on the XLCFE Notes, which were issued by XL Capital Finance (Europe) plc, was repaid at maturity. For further detail, see Item 1, Note 13, Notes Payable and Debt Financing Arrangements, to the Consolidated Financial Statements included herein.

Risk Management

Our risk management and risk appetite framework is detailed in Item 1, Business Enterprise Risk Management, included herein. The table below shows our estimated per event net 1% and 0.4% exceedance probability exposures for certain peak natural catastrophe peril regions. These estimates assume that amounts due from reinsurance and retrocession purchases are 100% collectible. There may be credit or other disputes associated with these potential receivables.

Geographical Zone *(U.S. dollars in millions)*	**Peril**	**Measurement Date of In-Force Exposures (1)**	**1% Exceedance Probability**		**0.4% Exceedance Probability**	
			Probable Maximum Loss (2)	**Percentage of Tangible Shareholders**	**Probable Maximum Loss (2)**	**Percentage of Tangible Shareholders**

					Equity at December 31, 2012			Equity at December 31, 2012
North Atlantic	Windstorm	October 1, 2012	$	1,283	11.2 %	$	1,708	14.9 %
North America	Earthquake	October 1, 2012		838	7.3 %		1,371	12.0 %
Europe	Windstorm	October 1, 2012		509	4.4 %		708	6.2 %
Japan	Earthquake	October 1, 2012		284	2.5 %		358	3.1 %
Japan	Windstorm	October 1, 2012		195	1.7 %		265	2.3 %

(1) Detailed analyses of aggregated in-force exposures and maximum loss levels are done periodically. The measurement dates represent the date of the last completed detailed analysis by geographical zone.

(2) Probable maximum losses, which include secondary uncertainty that incorporates variability around the expected probable maximum loss for each event, do not represent our maximum potential exposures and are pre-tax.

See Significant Items Affecting the Results of Operations 1) The impact of significant large loss events above.

Regulatory Change

Management continues to actively monitor and assess the various regulatory initiatives and legislation that impacts us or in the future could impact us. For example, management has been focused on Solvency II, which was adopted by the European Parliament in April 2009. This is an E.U. directive covering the capital adequacy and risk management of, and regulatory reporting for, European-based (re)insurers, as well as a new supervisory regime for the insurance industry. Several steps must be taken by the European Commission, the European Parliament, the Council of Ministers and EIOPA to implement Solvency II. The final date of implementation and key elements of the framework remain under discussion, but it is widely accepted that the envisaged implementation date of January 1, 2014 will not be met. However, management currently continues to prepare for potential Solvency II implementation at a future date. See Item 1, Business Regulation.

Critical Accounting Policies and Estimates

The following are considered to be our critical accounting policies and estimates due to the judgments and uncertainties affecting the application of these policies and/or the likelihood that materially different amounts would be reported under different conditions or using different assumptions. If actual events differ significantly from the underlying assumptions or estimates applied for any or all of the accounting policies (either individually or in the aggregate), there could be a material adverse effect on our results of operations, financial condition and liquidity. We have discussed these critical accounting policies with the Audit Committee of our Board of Directors.

Other significant accounting policies are nevertheless important to an understanding of our Consolidated Financial Statements. Policies such as those related to revenue recognition, financial instruments and consolidation require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. See Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included herein for further information.

1) Unpaid Loss and Loss Expenses and Unpaid Loss and Loss Expenses Recoverable

As we earn premiums for the underwriting risks we assume, we also establish an estimate of the expected ultimate losses related to the premium. Loss reserves for unpaid loss and loss expenses are established due to the significant periods of time that may elapse between the occurrence, reporting and settlement of a loss. The process of establishing reserves for unpaid property and casualty claims can be complex and is subject to considerable variability, as it requires the use of informed estimates and judgments. These estimates and judgments are based on numerous factors, and may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed or as current laws change. Loss reserves include:

a) Case reserves reserves for reported losses and loss expenses that have not yet been settled; and

b)

IBNR reserves reserves for incurred but not reported losses or for reported losses over and above the amount of case reserves.

Case Reserves

Case reserves for our property and casualty operations are established by management based on amounts reported from insureds or ceding companies and consultation with legal counsel, and represent the estimated ultimate cost of events or conditions that have been reported to or specifically identified by us. The method of establishing case reserves for reported claims differs among our operations.

With respect to our insurance operations, we are notified of insured losses and record a case reserve for the estimated amount of the settlement, if any. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of legal counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. With respect to our reinsurance operations, case reserves for reported claims are generally established based on reports received from ceding companies. Additional case reserves may be established by us to reflect the estimated ultimate cost of a loss. The uncertainty in the reserving process for reinsurers is due, in part, to the time lags inherent in reporting from the original claimant to the primary insurer to the reinsurer. As a predominantly broker market reinsurer for both excess-of-loss and proportional contracts, we are subject to a potential additional time lag in the receipt of information as the primary insurer reports to the broker who in turn reports to us.

Since we rely on information regarding paid losses, case reserves and IBNR provided by ceding companies in order to assist us in estimating our liability for unpaid losses and LAE, we maintain certain procedures in order to help determine the completeness and accuracy of such information. Periodically, management assesses the reporting activities of our ceding companies on the basis of qualitative and quantitative criteria. In addition to conferring with ceding companies or brokers on claims matters, our claims personnel 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 proper reinsurance premium for reinsurance agreements and to establish proper loss reserves. Disputes with ceding companies have been rare and generally have been resolved through negotiation.

In addition to information received from ceding companies on reported claims, we also utilize information on the pattern of ceding company loss reporting and loss settlements from previous catastrophic events in order to estimate our ultimate liability related to catastrophic events such as hurricanes. Commercial catastrophe model analyses and zonal aggregate exposures are utilized to assess potential client loss before and after an event. Initial cedant loss reports are generally obtained shortly after a catastrophic event, with subsequent updates received as new information becomes available. We actively request loss updates from cedants periodically while there is still considerable uncertainty for an event, often for the first year following an event. Our claim settlement processes also incorporate an update to the total loss reserve at the time a claim payment is made to a ceding company.

While the reliance on loss reports from ceding companies may increase the level of uncertainty associated with the estimation of total loss reserves for property catastrophe reinsurance relative to direct property insurance, there are several factors which serve to reduce the uncertainty in loss reserve estimates for property catastrophe reinsurance. First, for large natural catastrophe events, aggregate limits in property catastrophe reinsurance contracts are generally fully exhausted by the loss reserve estimates. Second, as a reinsurer, we have access to information from a broad cross section of the insurance industry. We utilize such information in order to perform consistency checks on the data provided by ceding companies and are able to identify trends in loss reporting and settlement activity and incorporate such information in our estimate of IBNR reserves. Finally, we also supplement the loss information received from cedants with loss estimates developed by market share techniques and/or from third party catastrophe models applied to exposure data supplied by cedants.

IBNR Reserves

IBNR reserves represent management s best estimate, at a given point in time, of the amount in excess of case reserves that is needed for the future settlement and loss adjustment costs associated with claims incurred. It is possible that the ultimate liability may differ materially from these estimates. Because the ultimate amount of unpaid losses and LAE is uncertain, we believe that quantitative techniques to estimate these amounts are enhanced by professional and managerial judgment. Management reviews the IBNR estimates produced by our actuaries who determine the best estimate of the liabilities to record in our financial statements. We consider this single point estimate to be the mean expected outcome.

IBNR reserves are estimated by our actuaries using several standard actuarial methodologies including the loss ratio method, the loss development or chain ladder method, the Bornhuetter-Ferguson (BF)

method and frequency and severity approaches. IBNR related to a specific event may be based on our estimated exposure to an industry loss and may include the use of catastrophe modeling software. On a quarterly basis, IBNR reserves are reviewed by our actuaries, and are adjusted as new information becomes available. Any such adjustments are accounted for as changes in estimates and are reflected in the results of operations in the period in which they are made.

Our actuaries use one set of assumptions in calculating the single point estimate, which includes actual loss data, loss development factors, loss ratios, reported claim frequency and severity. The actuarial reviews and documentation are completed in accordance with professional actuarial standards with reserves established on a basis consistent with GAAP. The selected assumptions reflect the actuary s judgment based on historical data and experience combined with information concerning current underwriting, economic, judicial, regulatory and other influences on ultimate claim settlements.

When estimating IBNR reserves, each of our insurance and reinsurance business units segregate business into exposure classes. Within each class, the business is further segregated by either the year in which the contract incepted (underwriting year), the year in which the claim occurred (accident year), or the year in which the claim is reported (report year). The majority of the Insurance segment is reviewed on an accident year basis. Professional lines insurance business is reviewed on a report year basis due to the claims made nature of the underlying policies. The majority of the Reinsurance segment is reviewed on an underwriting year basis. In each case we believe the selected method most accurately represents the economic condition of the business.

Generally, initial actuarial estimates of IBNR reserves not related to a specific event are based on the loss ratio method applied to each class of business. Actual paid losses and case reserves (reported losses) are subtracted from expected ultimate losses to determine IBNR reserves. The initial expected ultimate losses involve management judgment and are based on historical information for that class of business; which includes loss ratios, market conditions, changes in pricing and conditions, underwriting changes, changes in claims emergence, and other factors that may influence expected ultimate losses.

Over time, as a greater number of claims are reported, actuarial estimates of IBNR are based on the BF method and loss development techniques. The BF method utilizes actual loss data and the expected patterns of loss emergence, combined with an initial expectation of ultimate losses to determine an estimate of ultimate losses. This method may be appropriate when there is limited actual loss data and a relatively less stable pattern of loss emergence. The chain ladder method utilizes actual loss and expected patterns of loss emergence to determine an estimate of ultimate losses that is independent of the initial expectation of ultimate losses. This method may be appropriate when there is a relatively stable pattern of loss emergence and a relatively larger number of reported claims. Multiple estimates of ultimate losses using a variety of actuarial methods are calculated for each of our classes of business for each year of loss experience. Our actuaries look at each class and determine the most appropriate point estimate based on the characteristics of the particular class and other relevant factors, such as historical ultimate loss ratios, the presence of individual large losses, and known occurrences that have not yet resulted in reported losses. Once our actuaries make their determination of the most appropriate point estimate for each class, this information is aggregated and presented to management for review and approval.

The pattern of loss emergence is determined using actuarial analysis and judgment and is based on the historical patterns of the recording of paid and reported losses by us, as well as industry information. Information that may cause historical patterns to differ from future patterns is considered and reflected in expected patterns as appropriate. For property, marine and aviation insurance, losses are generally reported within 2 to 3 years from the beginning of the accident year. For casualty insurance, loss emergence patterns can vary from 3 years to over 20 years depending on the type of business. For other insurance, loss emergence patterns fall between the property and casualty insurance. For reinsurance business, loss reporting lags the corresponding insurance classes often by at least one quarter due to the need for loss information to flow from the ceding companies to us generally via reinsurance intermediaries. Such lags in loss reporting are reflected in the actuary s selections of loss reporting patterns used in establishing our

reserves.

Such estimates are not precise because, among other things, they are based on predictions of future developments and estimates of future trends in claim severity, claim frequency and other issues. In the process of estimating IBNR reserves, provisions for economic inflation and changes in the social and legal

environment are considered, but involve considerable judgment. When estimating IBNR reserves, more judgment is typically required for lines of business with longer loss emergence patterns.

Due to the low frequency and high severity nature of some of the business underwritten by us, our reserve estimates are highly dependent on actuarial and management judgment and are therefore uncertain. In property classes, there can be additional uncertainty in loss estimation related to large catastrophe events. With wind events, such as hurricanes, the damage assessment process may take more than a year. The cost of claims is subject to volatility due to supply shortages for construction materials and labor. In the case of earthquakes, the damage assessment process may take several years as buildings are discovered to have structural weaknesses not initially detected. The uncertainty inherent in IBNR reserve estimates is particularly pronounced for casualty coverages, such as excess liability, professional liability coverages and workers compensation, where information emerges relatively slowly over time.

Our three types of property and casualty reserve exposure with the longest tails are:

(1) high layer excess casualty insurance;

(2) casualty reinsurance; and

(3) discontinued asbestos and long-tail environmental business.

Certain aspects of our casualty operations complicate the actuarial process for establishing reserves. Certain casualty business written by our insurance operations is high layer excess casualty business, meaning that our liability attaches after large deductibles, including self insurance or insurance from sources other than us. We commenced writing this type of business in 1986 and issued policies in forms that were different from traditional policies used by the industry at that time. Initially, there was a lack of industry data available for this type of business. Consequently, the basis for establishing loss reserves by us for this type of business was largely judgmental and based upon our own reported loss experience, which was used as a basis for determining ultimate losses and, therefore, IBNR reserves. Over time, the amount of available historical loss experience data has increased. As a result, we have obtained a larger statistical base to assist in establishing reserves for these excess casualty insurance claims.

High layer excess casualty insurance claims typically involve claims relating to (i) a shock loss such as an explosion or transportation accident causing severe damage to persons and/or property over a short period of time, (ii) a non-shock loss where a large number of claimants are exposed to injurious conditions over a longer period of time, such as exposure to chemicals or pharmaceuticals or (iii) a professional liability loss such as a medical malpractice claim. In each case, these claims are ultimately settled following extensive negotiations and legal proceedings. This process typically takes 5 to 15 years following the date of loss.

Reinsurance operations by their nature add further complications to the reserving process, particularly for casualty business written, in that there is an inherent lag in the timing and reporting of a loss event from an insured or ceding company to the reinsurer. This reporting lag creates an even longer period of time between the policy inception and when a claim is finally settled. As a result, more judgment is required to establish reserves for ultimate claims in our reinsurance operations.

In our reinsurance operations, case reserves for reported claims are generally established based on reports received from ceding companies. Additional case reserves may be established by us to reflect our estimated ultimate cost of a loss.

Casualty reinsurance business involves reserving methods that generally include historical aggregated claim information as reported by ceding companies, combined with the results of claims and underwriting reviews of a sample of the ceding company s claims and underwriting files. Therefore, we do not always receive detailed claim information for this line of business.

Discontinued asbestos and long-tail environmental business was contained within certain policies previously written by NAC Re Corp. (now known as XL Reinsurance America Inc.), prior to its acquisition by us; from business of Winterthur purchased by us from AXA Insurance in 2001; and from a loss portfolio transfer in 2006. At December 31, 2012, total gross unpaid losses and loss expenses in respect of this business represented less than 1% of unpaid losses and loss expenses. See Note 10(f), Losses and Loss Expenses Discontinued Asbestos and Run-Off Environmental Related Claims, to the Consolidated Financial Statements included herein for further information.

Except for certain workers compensation (including long-term disability) and certain U.K. motor liabilities, we do not discount our unpaid losses and loss expenses. We utilize tabular reserving for workers compensation unpaid losses that are considered fixed and determinable. The unpaid losses for the annuity component of U.K. motor claims are discounted to reflect the long tail nature of the structured settlements. For further discussion, see Note 10, Losses and Loss Expenses, to the Consolidated Financial Statements included herein.

Loss and loss expenses are charged to income as they are incurred. These charges include loss and loss expense payments and any changes in case and IBNR reserves. During the loss settlement period, additional facts regarding claims are reported. As these additional facts are reported, it may be necessary to increase or decrease the unpaid losses and loss expense reserves. The actual final liability may be significantly different than prior estimates.

The amount of our net unpaid losses and loss expenses relating to our operating segments at December 31, 2012 and 2011 was as follows.

(U.S. dollars in thousands)	**2012**	**2011**
Insurance	$ 11,384,855	$ 11,374,315
Reinsurance	5,737,564	5,609,658
Net unpaid losses and loss expenses	$ 17,122,419	$ 16,983,973

	Net Unpaid Losses and Loss Expenses					
	2012			**2011**		
(U.S. dollars in millions)	**Case Reserves**	**IBNR Reserves**	**Total Reserves**	**Case Reserves**	**IBNR Reserves**	**Total Reserves**
Insurance:						
Professional	$ 1,399	$ 3,040	$ 4,439	$ 1,244	$ 3,175	$ 4,419
Casualty	1,362	3,014	4,376	1,395	2,919	4,314
Property	367	199	566	473	299	772
Specialty	674	568	1,242	734	559	1,293
Other (1)	243	518	761	196	380	576
Total	**$ 4,045**	**$ 7,339**	**$ 11,384**	**$ 4,042**	**$ 7,332**	**$ 11,374**
Reinsurance:						
Casualty (2)	$ 1,490	$ 2,039	$ 3,529	$ 1,501	$ 1,999	$ 3,500
Property catastrophe (3)	166	248	414	180	197	377
Other property	462	538	1,000	410	467	877
Marine, energy, aviation and satellite	387	119	506	399	71	470
Other (1)	180	109	289	163	223	386

Total		**2,685**		**3,053**		**5,738**		**2,653**		**2,957**		**5,610**
TOTAL	**$**	**6,730**	**$**	**10,392**	**$**	**17,122**	**$**	**6,695**	**$**	**10,289**	**$**	**16,984**

(1) Other within the Insurance segment includes: excess and surplus, surety, structured indemnity and certain other discontinued lines. Other within the Reinsurance segment includes: whole account contracts, surety, structured indemnity and other lines.

(2) Within the Reinsurance segment, casualty-other and casualty-professional lines of business are shown in the aggregate.

(3) Property catastrophe IBNR includes event specific reserves for losses that our insureds and cedants have informed us they expect to incur but have not yet had reported known claims.

As noted above, management reviews the IBNR estimates produced by our actuaries who determine the best estimate of the liabilities to record in our financial statements. We consider this single point estimate to be the mean expected outcome. Management believes that the actuarial methods utilized adequately provide for loss development.

Management does not build in a provision for uncertainty outside of the estimates prepared by our actuaries.

While the proportion of unpaid losses and loss expenses represented by IBNR is sensitive to a number of factors, the

most significant ones have historically been accelerated business growth and changes in business mix. Other factors that have affected the ratio in the past include additions to prior period

reserves, catastrophic occurrences, settlement of large claims and changes in claims settlement patterns. The ratio of IBNR to total reserves was consistent from year-end 2011 to year-end 2012.

IBNR reserves are calculated by our actuaries using standard actuarial methodologies as discussed above. Since the year ended December 31, 2003, we adopted a methodology that provides a single point reserve estimate separately for each line of business and also a range of possible outcomes across each single point reserve estimate. This is discussed further below.

The following table shows the recorded estimate and the high and low ends of the range of our net unpaid losses and loss expenses for each of the lines of business noted above at December 31, 2012:

(U.S. dollars in millions)	**Net Unpaid Losses and Loss Expenses Recorded**	**Range of Net Unpaid Losses & Loss Expenses Estimated HIGH**	**Range of Net Unpaid Losses & Loss Expenses Estimated LOW**
Insurance			
Professional	$ 4,439	$ 4,935	$ 3,963
Casualty	4,376	4,909	3,866
Property	566	648	490
Specialty	1,242	1,349	1,140
Other (1)	761	888	642
Total (2)	$ 11,384	12,359	10,442
Reinsurance			
Casualty (3)	$ 3,529	$ 3,935	$ 3,141
Property catastrophe	414	531	308
Other property	1,000	1,241	779
Marine, energy, aviation and satellite	506	602	418
Other (1)	289	328	250
Total (2)	$ 5,738	6,353	5,147
Total	$ 17,122		

(1) Other within the Insurance segment includes: excess and

surplus, surety, structured indemnity and certain other discontinued lines. Other within the Reinsurance segment includes: whole account contracts, surety, structured indemnity and other lines.

(2) The range for the total Insurance and Reinsurance segment reserves is narrower than the sum of the ranges for the lines of business shown in the table due to diversification benefits across the lines of business.

(3) Within the Reinsurance segment, casualty-other and casualty-professional lines of business are shown in the aggregate.

There are factors that would cause reserves to increase or decrease within the context of the range provided. The magnitude of any change in ultimate losses would be determined by the magnitude of any changes to our assumptions or combined impact of changes in assumptions. Factors that would increase reserves include, but are not limited to, increases in claim severity, increases in expected level of reported claims, changes to the regulatory environment that expand the exposure insured by us, changes in the litigation environment that increase claim awards, filings or verdicts, unexpected increases in loss inflation, and/or new types of claims being pursued against us. Factors that would decrease reserves include, but are not limited to, decreases in claim severity, reductions in the expected level of reported claims, changes to the regulatory environment that reduce the exposure insured by us, changes in the litigation environment that decrease claim awards, filings or verdicts, and/or unexpected decreases in loss inflation.

Our methodology in 2012 for calculating reserve ranges around our single point reserve estimate is consistent with that used in 2011. We modeled a statistical distribution of potential reserve outcomes over a one year run-off period for each of the approximately 35 lines of business. Where appropriate, lines of business were evaluated at a more granular level and then aggregated to appropriately reflect differing levels of volatility within each line of business, for example, in respect of attritional, large, catastrophe and clash losses. In doing so we evaluated a number of alternative models, and for each line of business our actuaries selected the distribution parameters deemed to be most appropriate. Factors affecting this decision included an assessment of the model fit, availability and relevance of data and the impact of changes in business mix. We used the modeled statistical distribution to calculate an 80% confidence interval for the potential reserve outcomes over this one year run-off period. The high and low end points of the ranges set

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forth in the above table are such that there is a 10% modeled probability that the reserve will develop higher than the high point and a 10% modeled probability that the reserve will develop lower than the low point.

The development of a reserve range models the uncertainty of the claim environment as well as the limited predictive power of past loss data. These uncertainties and limitations are not specific to us. The ranges represent an estimate of the range of possible outcomes over a one year development period. A range of possible outcomes should not be confused with a range of best estimates. The range of best estimates will generally be much narrower than the range of possible outcomes as it will reflect reasonable actuarial best estimates of the expected reserve.

Reserve volatility was analyzed for each line of business (excluding structured indemnity) within both the Reinsurance and Insurance segments using our historical data, supplemented by industry data. These ranges were then aggregated to the lines of business shown above taking into account correlation between lines of business. The practical result of the correlation approach to aggregation is that the ranges by line of business disclosed above are narrower than the sum of the ranges of the individual lines of business. Similarly, the range for our total reserves in the aggregate, is narrower than the sum of the ranges for the lines of business disclosed above.

On an annual basis, we review the correlation assumptions between our various lines of business. Since 2006, we have utilized a simplified approach of assigning ratings of low, medium or high to its correlation assumptions for each line of business pairing based on the judgment of the reserving actuaries. This simplified approach has been utilized due to the limited amount of historical experience within our portfolio as well as limited applicable industry data. However, our actual historical experience and industry data were used to judgmentally select a range of values for the low, medium and high correlations, respectively, of 15%, 30% and 50%. It should be noted that both our own experience and the industry data exhibit negative correlations in reserve developments between certain lines of business. However, as a measure of prudence in evaluating the reserve ranges, we have used a minimum of 15% correlation between any two lines of business. The analysis of correlations and the reflection of potential diversification benefits across lines of business represent another area of uncertainty in the development of estimated reserve ranges.

We are not aware of any generally accepted model to perform the reserve range analysis described above. However, other models may be employed to develop these ranges.

See Segments below for further discussion on prior year development of loss reserves.

Unpaid losses and loss expenses recoverable

The recognition of unpaid losses and loss expenses recoverable requires two key judgments. The first judgment involves our estimation of the amount of gross IBNR to be ceded to reinsurers. Ceded IBNR is generally developed as part of our loss reserving process and, consequently, its estimation is subject to similar risks and uncertainties as the estimation of gross IBNR (see Critical Accounting Policies and Estimates Unpaid losses and loss expenses and unpaid loss and loss expense recoverable). The second judgment involves our estimate of the amount of the reinsurance recoverable balance that we will ultimately be unable to recover from related reinsurers due to insolvency, contractual dispute, or for other reasons. Amounts estimated to be uncollectible are reflected in a bad debt provision that reduces the reinsurance recoverable balance. Changes in the bad debt provision are reflected in net income. See Item 8, Note 9, Reinsurance, to the Consolidated Financial Statements included herein, for further information.

We use a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer, net of collateral, estimated recovery rates and default factors used to determine the portion of a reinsurer s balance deemed uncollectible. The definition of collateral for this purpose requires some judgment and is generally limited to assets held in trust, letters of credit, and liabilities held by us with the same legal entity for which we believe there is a right of offset. Default factors require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

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2) Future Policy Benefit Reserves

Future policy benefit reserves relate to our Life operations and are estimated using assumptions for investment yields, mortality, expenses and provisions for adverse loss deviation. Uncertainties related to interest rate volatility and mortality experience make it difficult to project and value the ultimate benefit payments.

Most of our future policy benefit reserves relate to annuity portfolio reinsurance contracts under which we make annuity payments throughout the term of the contract for a specified portfolio of policies.

The future policy benefit reserves for annuity portfolio reinsurance contracts amounted to $4.0 billion at both December 31, 2012 and 2011. The requirement to unlock assumptions used to value these reserves arising from changes to assumptions on investment yield and mortality is discussed below along with sensitivities for changing mortality and investment yield assumptions.

For certain of these contracts, a single premium is paid at inception of the contract by way of a transfer of cash and investments to us.

The reserving methodology for these annuity portfolio reinsurance contracts is described in the authoritative guidance issued by the FASB for accounting and reporting by insurance for certain long-duration contracts as well as authoritative guidance over realized gains and losses from the sale of investments. These contracts subject us to risks arising from policyholder mortality over a period that extends beyond the periods in which premiums are collected. Liabilities for future policy benefit reserves are established in accordance with the provisions of this guidance.

Claims and expenses for individual policies within these annuity reinsurance contracts are projected over the lifetime of the contract to calculate a net present value of future cash flows. Assumptions for each element of the basis (mortality, expenses and interest) are determined at the issue of the contract and these assumptions are locked-in throughout the term of the contract unless a premium deficiency exists. The assumptions are best estimate assumptions plus provisions for adverse deviations on the key risk elements (i.e., mortality and interest). Provisions for adverse deviation are designed to cover reasonable deviations from the best estimate outcome of the contract. As the experience on the contracts emerges, the assumptions are reviewed. This occurs at least annually and includes both an analysis of experience and review of likely future experience. If such review would produce reserves in excess of those currently held then lock-in assumptions will be revised and a loss recognized. Such a loss could be significant relative to the net income of the Life operations segment for the year, but would not be expected to be significant relative to shareholders equity. The future policy benefit reserves provisions for adverse deviation in excess of best estimate assumptions consistent with the underlying pricing that amounted to approximately $52 million and $36 million at December 31, 2012 and 2011, respectively. The reduction in 2012 has arisen due to the narrowing of credit spreads on the underlying assets over the year.

The future policy benefit reserves would only be increased if these provisions for adverse deviation no longer existed in the light of emerging claims experience. The present value of future claims would increase by approximately $17 million if mortality rates were to decrease by 1% in all future years, relative to the reserving assumptions. We hold the investment assets backing these liabilities. These investments are primarily fixed income securities with maturities that closely match the expected claims settlement profile. A 0.1% decrease in the investment yield assumption would result in approximately a $32 million increase in the value of future claims related to annuity portfolio reinsurance.

During the years ended December 31, 2012, 2011 and 2010, there were no adjustments to the locked-in assumptions for these annuity reinsurance contracts.

We also provide reinsurance of disability income protection, for an in-force block of business. The future policy benefit reserves for these contracts amounted to approximately $101 million and $99 million at December 31, 2012 and 2011, respectively. Future policy benefit reserves include the lock-in of assumptions at inception with periodic

review against experience. The liabilities relate to in-force blocks of business, comprising underlying insurance policies that provide an income if the policyholder becomes sick or disabled. The liabilities are therefore driven mainly by the rates at which policyholders become sick (where sickness is defined by the policy conditions) and by the rates at which these policyholders recover or die. A 1% increase in the incidence rate would increase the value of future claims by approximately $2.3 million, while a 1% decrease in the termination rate would increase the value of future claims by

approximately $4.1 million. While no changes to the locked-in assumptions were made in 2012 or in 2011, a review of lapse experience in 2010 led to an increase in the reserve of $2.2 million.

We also provide reinsurance of term assurance and critical illness policies written in the U.K., Ireland and the United States. The future policy benefit reserves for these contracts amounted to approximately $271 million and $241 million at December 31, 2012 and 2011, respectively. This increase was caused by ageing of the portfolio, combined with movements of the U.K. sterling and Euro against the U.S. dollar over 2012. Future policy benefit reserves include the lock-in of assumptions at inception with periodic review against experience. The provisions for adverse deviation in these reserves amounted to approximately $24 million and $22 million at December 31, 2012 and 2011, respectively.

The liabilities relate to in-force blocks of business and to treaties that accepted new business up until the end of 2009, comprising underlying insurance policies that provide mainly lump sum benefits if the policyholder dies or becomes sick. For term assurance, the liabilities are therefore driven by the rates of mortality and for critical illness cover, the liabilities are driven predominantly by the rates at which policyholders become sick, where sickness is defined by the treaty conditions (i.e., the morbidity rates). A 1% increase in the mortality rate relative to the reserving assumption would increase the value of future claims by approximately $2.7 million, and a 1% increase in the morbidity rate would increase the value of future claims by approximately $1.0 million.

The term assurance and critical illness treaties were written using a variety of structures, some of which incur acquisition costs during an initial period. For such treaties, a deferred acquisition cost (DAC) asset has been established and an increase in future lapse rates could impact the recoverability of such costs from future premiums. The recoverability will also be influenced by the impact of lapses on future claims. An increase in the annual lapse rates by 1% could lead to a 5%-10% reduction in future margins available for amortizing the DAC asset.

We also provided reinsurance of a block of U.S. based term assurance, which was novated to us from an insurance affiliate in December 2002. The future policy benefit reserves for these contracts amounted to approximately $257 million and $258 million at December 31, 2012 and 2011, respectively. Future policy benefit reserves are established in accordance with the provisions of general authoritative guidance on accounting for insurance enterprises, including the lock-in of assumptions at inception with periodic review against experience.

The liabilities relate to in-force blocks of business, which are comprised of underlying insurance policies that provide mainly lump sum benefits if the policyholder dies. The liabilities are therefore driven by the rates of mortality, and a 1% increase in the mortality rate relative to the reserving assumption would increase the value of future claims by approximately $7 million. The liabilities are also affected by lapse experience, and a 1% decrease in lapse rates relative to the reserving assumption would increase the reserve by approximately $0.8 million. No changes to the locked-in assumptions were made in years ended December 31, 2012, 2011 and 2010.

For further information see Item 8, Note 12, Future Policy Benefit Reserves, to the Consolidated Financial Statements included herein.

3) Other-Than-Temporary Declines in Investments (OTTI)

Our process for identifying declines in the fair value of investments that are other-than-temporary involves consideration of several factors. These primary factors include (i) an analysis of the liquidity, business prospects and financial condition of the issuer including consideration of credit ratings, (ii) the significance of the decline, (iii) an analysis of the collateral structure and other credit support, as applicable, of the securities in question, and (iv) for debt securities, whether we intend to sell such securities. In addition, the authoritative guidance requires that OTTI for certain asset backed and mortgage backed securities are recognized if the fair value of the security is less than its discounted cash flow value and there has been a decrease in the present value of the expected cash flows since the last reporting period. Where our analysis of the above factors results in our conclusion that declines in fair values are

other-than-temporary, the cost of the security is written down to discounted cash flow and a portion of the previously unrealized loss is therefore realized in the period such determination is made.

If we intend to sell an impaired debt security, or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, the impairment is other-than-temporary and is recognized in earnings in an amount equal to the entire difference between fair value and amortized cost.

There are risks and uncertainties associated with determining whether declines in the fair value of investments are other-than-temporary. These include subsequent significant changes in general economic conditions as well as specific business conditions affecting particular issuers, our liability profile, subjective assessment of issue-specific factors (seniority of claims, collateral value, etc.), future financial market effects, stability of foreign governments and economies, future rating agency actions and significant disclosure of accounting, fraud or corporate governance issues that may adversely affect certain investments. In addition, significant assumptions and management judgment are involved in determining if the decline is other-than-temporary. If management determines that a decline in fair value is temporary, then a security s value is not written down at that time. However, there are potential effects upon our future earnings and financial position should management later conclude that some of the current declines in the fair value of the investments are other-than-temporary declines. See Investment Activities herein for further information on other-than-temporary declines in the value of investments and unrealized loss on investments.

Key Assumptions used in determination of credit losses related to fixed maturities

We review, on a quarterly basis, the entirety of the fixed maturity securities in our investment portfolio that are in a gross unrealized loss position to assess whether we believe a credit loss, relative to the current amortized cost of the security, exists. We utilize specific screening criteria to identify securities at risk for a credit loss, and if any of these conditions exists, subject the individual security to a detailed review to determine if a credit loss exists. The screening criteria used by us include the absolute degree of impairment of the security as a percentage of amortized cost, the credit rating of the security and the market yield-to-maturity of the security. Any securities that have previously been identified as impaired due to credit losses are at elevated risk of further impairments. In addition, on a quarterly basis, we review any current market developments and identify any new issues that may adversely impact our investment portfolio, and review any impacted holdings and any pending sales programs.

Credit loss methodology structured securities

Credit loss on structured securities is determined through a comparison of the security s discounted cash flow to the amortized cost of the security. To the extent that the discounted cash flow is estimated to be lower than the amortized cost of the security, the security is impaired to the discounted cash flow value of all security cash flows, including both coupon and principal repayment, discounted using the forward curve.

We, in conjunction with our third-party investment management service providers, make significant assumptions in our impairment analysis and these assumptions are subject to changes in both economic fundamentals and management s estimates in future periods.

(1) Non-Agency RMBS

We utilize assumptions specific to our individual holdings and, accordingly, individual assumptions will differ on a security by security basis depending on the quality of the collateral and the performance of the underlying pools. In general, we project that future defaults will develop based on the performance of the underlying collateral, measured by the number of loans currently in arrears.

Loans < 30 days in arrears	50% will ultimately default
Loans 30-60 days in arrears	60% will ultimately default
Loans 60-90 days in arrears	75% will ultimately default

Bank held	100% default rate
Loans in foreclosure	100% default rate

We estimate that the cumulative losses on the mortgage structures we own will vary depending on the vintage and collateral of the underlying loans in the holdings. Cumulative deal loss expectations are projected based on the number of loans expected to take a loss and the severity of loss upon default. Loan

loss severities depend on the borrower, geographic location and loan to value characteristics of the underlying collateral. We estimate that loss severities will range from 50-75% for sub-prime and Alt-A loans and 40-50% for Prime loans. These cumulative losses results are then compared to the level of subordination within our holdings to measure if impairment exists.

	Average Cumulative Losses by Vintage			
	2007	2006	2005	2004
Alt-A Non Option ARM	38 %	26 %	12 %	4 %
Alt-A Option ARM	36 %	33 %	16 %	5 %
Prime	20 %	13 %	6 %	2 %
Subprime	48 %	35 %	20 %	7 %

(2) Core CDOs

In conjunction with our investment managers, we utilize a scenario-based approach to reviewing the majority of our CDO portfolio, which consists primarily of collateralized loan obligations. The five significant scenarios utilized in the model consist of:

- 2 base cases assuming asset defaults are equivalent to either the expected corporate default probabilities, or the cumulative default rates for similar time frames from the period of 1983 to 2010.

- Optimistic/pessimistic cases assuming assets have a default rate equivalent to 1 rating notch higher/ lower than their current rating and if on positive/negative watch then 2 notches higher/lower than their current rating.

- A market implied scenario based on the current asset market price, assuming that lower priced loans have a higher default

rate.

The weighted scenario of the five scenarios above is used for the determination of a potential impairment. If losses are forecast to be below the subordination level for the tranche held by us, the security is determined not to be impaired. The weighting between these scenarios varies over time depending on market conditions, but the weighting used for the year end 2012 evaluation consisted of 40% to the base cases noted above, 10% to the optimistic case, 10% to the pessimistic case, and 40% to the market implied case. For the non-CLO portion of the core CDO portfolio, we utilize specific default scenarios related to the particular underlying assets.

(3) Other structured security classes

The remainder of the gross unrealized losses related to our structured securities portfolio are concentrated in the following significant asset classes:

Other ABS, which is a mix of mostly investment grade credit card, auto and non-U.S. ABS structures that have risk and performance characteristics unrelated to the U.S. housing market. In cases where these sectors have met Company screens, the individual securities are evaluated based on fundamental credit analysis of the underlying structure.

CMBS, which are dominated by AAA rated holdings which generally have high levels of

credit subordination, are highly diversified and priced reasonably close to par. The gross unrealized losses on CMBS are spread evenly across the credit ratings. We review these holdings on an individual security basis to the extent they meet the screens noted above, but generally do not believe these securities have a high risk of credit loss given their high subordination levels.

Credit loss analysis corporate sector securities

Credit losses on corporate securities are determined on an individual security basis. We review the circumstances and conditions associated with credit issuers, including considering credit rating and forecasted operating and financing activities of the issuer, and will make a determination as to whether we believe the issuer is likely to fully meet its contractual principal and interest obligations. To the extent we do not believe the issuers will meet these obligations, we recognize a credit loss as the difference between amortized cost and the estimated present value of cash flows expected to be received. We review the ability

to pay at the lowest tier (i.e., most subordinated) of the capital structure at which we hold securities, and, to the extent we are satisfied in the performance of the lower tier, conclude that any more senior tiers are also likely to meet obligations.

We evaluate the credit losses associated with medium term notes, which generally represent notes backed primarily by investment grade European credit. We evaluate the cash flows expected from the notes over their remaining expected life, including an evaluation of the likelihood of current holdings to meet their principal and interest obligations, and incorporate current reinvestment assumptions on any security maturities or reinvestment of cash flows. These cash flows are discounted at the current yield, adjusted for changes in interest rates for floating rate securities expected from these securities, and, to the extent the discounted cash flow value is below the amortized cost, we recognize an impairment charge.

4) Income Taxes

We utilize the asset and liability method of accounting for income taxes. Under this method, deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We had net operating tax loss carry forward balances of $83.1 million and $263.6 million against which a valuation allowance of $73.8 million and $239.1 million at December 31, 2012 and 2011, respectively, was established. We had realized capital loss carry forward balances of approximately $196.5 million and $237.2 million against which a valuation allowance of approximately $196.5 million and $237.2 million at December 31, 2012 and 2011, respectively, was established. Included within these realized capital losses are $97.6 million and $117.9 million of losses arising from the intercompany sale of investments, against which a valuation allowance of $97.6 million and $117.9 million has been established. The deferral of benefits from tax losses is evaluated based upon management s estimates of the future profitability of our taxable entities based on current forecasts, the character of income and the period for which losses may be carried forward. A valuation allowance may have to be established for any portion of a deferred tax asset that management believes will not be realized. Should the future income of these entities fall below expectations, a further valuation allowance would have to be established, which could be significant. In addition, if any further losses are generated by these entities, these losses may not be tax affected.

For further information see Other Revenues and Expenses and Item 8, Note 22, Taxation, to the Consolidated Financial Statements included herein.

5) Reinsurance Premium Estimates

We write business on both an excess of loss and proportional basis. In the case of excess of loss contracts, the subject written premium is generally outlined within the treaty and we receive a minimum and/or deposit premium on a quarterly basis, which is normally followed by an adjustment premium based on the ultimate subject premium for the contract. We estimate the premium written on the basis of the expected subject premium and regularly review this against actual quarterly statements to revise the estimate based on the information provided by the cedant. An estimate of premium is recorded at the inception of the contract.

On proportional contracts, written premiums are estimated based on expected ultimate premiums using information provided by the ceding companies. The ceding company s premium estimate may be adjusted based on its history of providing accurate premium estimates. When the actual premium is reported by the ceding company, normally on a quarterly basis, it may be materially higher or lower than the estimate. Adjustments arising from the reporting of actual premium by the ceding companies are recorded at the earliest point in time that the supporting information indicates an adjustment is appropriate.

Written premiums on excess of loss contracts are earned in accordance with the loss occurring period defined within the treaty, normally 12 months following inception of the contract. Written premiums on proportional contracts are

earned over the risk periods of the underlying policies issued and renewed, normally 24 months. For both excess of loss and proportional contracts, the earned premium is recognized ratably over the earning period, namely 12-24 months. The portion of the premium related to the unexpired portion of the policy at the end of any reporting period is reflected in unearned premiums.

Reinstatement premiums are recognized at the time a loss event occurs where coverage limits for the remaining life of the contract are reinstated under pre-defined contract terms and are fully earned when recognized. Recognition of reinstatement premiums is based on our estimate of loss and loss adjustment expense reserves, which involves management judgment.

Reinsurance business by its nature can add further complications since, generally, the ultimate premium due under a specific contract will not be known at the time the contract is entered into. As a result, more judgment and ongoing monitoring is required to establish premiums written and earned in our reinsurance operations.

At December 31, 2012 and 2011, the amount of premiums receivable related to our reinsurance operations amounted to $1.2 billion and $1.1 billion, respectively.

A significant portion of amounts included as premiums receivable, which represent estimated premiums written, net of commissions, are not currently due based on the terms of the underlying contracts. Management reviews the premiums receivable balance at least quarterly and provides a provision for amounts deemed to be uncollectible. We recorded a provision for uncollectible premiums receivable related to our reinsurance operations at December 31, 2012 and 2011 of $0.9 million and $1.9 million, respectively.

The amount of proportional and excess of loss reinsurance gross premiums written and gross acquisition expenses recognized by our reinsurance operations for each line of business for the years ended December 31, 2012, 2011 and 2010 was as follows:

	2012		**2011**		**2010**	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**
Proportional Contracts:						
Casualty professional lines	$ 64,061	$ 17,512	$ 65,492	$ 19,422	$ 51,922	$ 14,604
Casualty other lines	120,830	32,013	115,835	30,657	38,671	9,945
Other property	484,610	133,640	693,825	145,367	651,733	168,981
Marine, energy, aviation and satellite	51,257	13,233	50,438	12,556	49,105	14,106
Other (1)	76,593	10,342	90,846	25,796	86,303	22,745
Total proportional contracts	$ 797,351	$ 206,740	$ 1,016,436	$ 233,798	$ 877,734	$ 230,381
Excess of Loss						

Contracts:

Casualty professional lines	$	157,296	$	29,439	$	151,897	$	28,055	$	166,379	$	30,969
Casualty other lines		211,731		36,843		176,672		26,602		190,864		30,764
Property catastrophe		537,086		52,762		461,742		43,705		370,266		37,720
Other property		168,904		11,238		153,991		17,659		150,761		16,363
Marine, energy, aviation and satellite		118,632		10,359		105,723		9,267		68,333		6,066
Other (1)		17,156		7,585		7,158		4,656		18,614		8,741
Total excess of loss contracts	$	1,210,805	$	148,226	$	1,057,183	$	129,944	$	965,217	$	130,623

(1) Other includes whole account, credit, surety, structured indemnity and other lines.

6) Goodwill and Other Intangible Assets

We have recorded goodwill in connection with various acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. We test goodwill for potential impairment annually as of June 30 and between annual tests if an event occurs or circumstances change that may indicate that potential exists for the fair value of a reporting unit to be reduced to a level below its carrying amount. We test for impairment at the reporting unit level in accordance with the authoritative guidance on intangibles and goodwill. For the reinsurance segment, a reporting unit is one level below the business segment, while for insurance, the segment is also the reporting unit. The first step is to identify potential impairment by comparing the estimated fair value of a reporting unit to the estimated book value, including goodwill. The fair value of each reporting unit is derived based upon valuation techniques and

assumptions we believe market participants would use to value the business and this is then compared to the book value of the business. We derive the net book value of our reporting units by estimating the amount of shareholders equity required to support the activities of each reporting unit. The estimated fair values of the reporting units are generally determined utilizing methodologies that incorporate price-to-net-tangible-book and price-to-earnings multiples of certain comparable companies, from an operational and economic standpoint. If such estimated fair value, combined with an estimate of an appropriate control premium, indicates a close call or potential impairment, further analysis using discounted cash flows is performed and the results of the various valuation methodologies are weighted to arrive at the estimated fair value for each reporting unit. A control premium represents the value an investor would pay above minority interest transaction prices in order to obtain a controlling interest in the respective company. If the estimated fair value exceeds the book value, goodwill at the reporting unit level is not deemed to be impaired. If the book value exceeds the estimated fair value, the second step of the process is performed to measure the amount of impairment.

We had goodwill of $392.9 million at December 31, 2012, all relating to the Reinsurance segment. The estimated fair values of the reporting units carrying goodwill exceeded their estimated net book values at December 31, 2012 and therefore no impairments were recorded during 2012. We completed an interim impairment test during the fourth quarter of 2011 that resulted in a non-cash goodwill impairment charge of $429.0 million representing the full amount of goodwill relating to the insurance segment. The impairment was determined using the methodologies as described above, which included discounted cash flow analyses and comparison with similar companies using their publicly traded price multiples as the basis for valuation. Continued low valuations in the insurance industry as a whole combined with several years of poor underwriting performance in the segment impacted the technical valuations resulting in the impairment; however, management continues to see significant value in our global insurance platform.

For further detailed information, see Item 8, Note 8, Goodwill and Other Intangible Assets, to the Consolidated Financial Statements included herein.

Segments

We are organized into three operating segments: Insurance, Reinsurance and Life operations. Our general investment and financing operations are reflected in Corporate.

We evaluate the performance of both the Insurance and Reinsurance segments based on underwriting profit and the performance of the Life operations segment based on its contribution to net income. Other items of our revenue and expenditure are not evaluated at the segment level for reporting purposes. In addition, we do not allocate investment assets by segment for our P&C operations. Investment assets related to our Life operations and certain structured products included in the Insurance and Reinsurance segments and in Corporate are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these segments. See Item 8, Note 4, Segment Information, to the Consolidated Financial Statements included herein, for a reconciliation of segment data to our consolidated financial statements.

In the following Income Statement Analysis discussion, the following ratios are used to explain the underwriting profit (loss) from our Insurance and Reinsurance segments:

The combined ratio related to the P&C operations is the sum of the loss and

loss expense ratio and the underwriting expense ratio. A combined ratio under 100% represents an underwriting profit and over 100% represents an underwriting loss.

The loss and loss expense ratio related to the P&C operations is calculated by dividing the losses and loss expenses incurred by the net premiums earned for the Insurance and Reinsurance segments.

The underwriting expense ratio related to the P&C operations is the sum of acquisition costs and operating expenses for the Insurance and Reinsurance segments divided by net premiums

earned for the Insurance and Reinsurance segments.

The acquisition expense ratio related to the P&C operations is calculated by dividing the acquisition costs incurred by the net premiums earned for the Insurance and Reinsurance segments.

The operating expense ratio related to the P&C operations is calculated by dividing the operating expenses incurred by the net premiums earned for the Insurance and Reinsurance segments.

Income Statement Analysis

Insurance

As outlined in Item 1, Business, our Insurance operations provide commercial property, casualty and specialty insurance products on a global basis. Products generally provide tailored coverages for complex corporate risks and include the following lines of business: property, casualty, professional liability, environmental liability, aviation and satellite, marine and offshore energy, equine, fine art and specie, surplus lines, political risk and trade credit, product recall, surety and other insurance coverages, including those mentioned above, through our programs, middle market and construction businesses. We focus on those lines of business within our insurance operations that we believe provide the best return on capital over time. These lines of business are divided into the following business groups: North America Property and Casualty (NAPC), International Property and Casualty (IPC), Global Professional Lines (Professional) and Global Specialty Lines (Specialty).

The following table summarizes the underwriting profit (loss) for the Insurance segment:

(U.S. dollars in thousands)	2012	2011	2010	Percentage change 2012 to 2011	Percentage change 2011 to 2010
Gross premiums written	$ 5,166,974	$ 4,824,665	$ 4,418,380	7.1 %	9.2 %
Net premiums written	4,072,513	3,707,664	3,461,150	9.8 %	7.1 %
Net premiums earned	3,924,640	3,663,727	3,529,138	7.1 %	3.8 %

Net losses and loss expenses	(2,691,056)	(2,951,413)	(2,505,502)	(8.8)%	17.8 %
Acquisition costs	(504,227)	(461,965)	(418,146)	9.1 %	10.5 %
Operating expenses	(754,306)	(683,814)	(642,103)	10.3 %	6.5 %
Underwriting profit (loss)	$ (24,949)	$ (433,465)	$ (36,613)	NM *	NM *
Net results structured products	20,980	10,976	14,696	91.1 %	(25.3)%
Net fee income and other (1)	(1,071)	(16,370)	(15,564)	(93.5)%	5.2 %

(1) Net fee income and other includes operating expenses from our loss prevention consulting services business.

* NM Not Meaningful

Gross Premiums Written

The following table summarizes our gross premiums written by business group for the Insurance segment:

(U.S. dollars in millions except percentages)	2012	Percentage	2011	Percentage	2010	Percentage	201 20
IPC	$ 1,215.9	23.5 %	$ 1,243.0	25.8 %	$ 1,111.7	25.2 %	(2
NAPC	1,599.1	30.9 %	1,333.0	27.6 %	1,066.8	24.1 %	20
Professional	1,460.0	28.3 %	1,377.6	28.6 %	1,412.1	32.0 %	6

Specialty		892.0	17.3 %		871.1	18.1 %		827.8	18.7 %	2
Total	$	5,167.0	100.0 %	$	4,824.7	100.0 %	$	4,418.4	100.0 %	7

2012 vs. 2011: Gross written premiums increased by 7.1%. The following is a summary of the premium movements by business group:

IPC decrease of 2.2% mainly due to lower retention and new business in property as a result of underwriting actions for business that did not meet our return requirements and the unfavorable impact of foreign exchange rates in all lines. Partially offsetting this decrease was improved retention levels and positive amendments to prior year premium estimates in primary casualty and middle market lines.

NAPC increase of 20.0% largely driven by

new business
growth
across most
lines
including
surplus lines,
construction
and primary
casualty,
improved
retention for
property,
construction,
and

primary casualty, and improved pricing in all lines over the prior year, partially offset by lower multi-year transactions in excess casualty.

Professional increase of 6.0% largely driven by improved pricing and retention as well as new business in the U.S. professional business, and favorable retention in the Select and International businesses, partially offset by lower new business in International.

Specialty increase of 2.4% due to the new political risk business and new business and favorable amendments to prior year premium estimates in marine, partially

offset by lower retention levels and adverse amendments to prior year premium estimates in aerospace.

Foreign exchange rate movements also impacted our gross premiums written. When evaluated in local currency, our gross written premiums increased by 8.8%, compared to the 7.1% shown above.

2011 vs. 2010: Gross written premiums increased by 9.2%. The following is a summary of the premium movements by business group:

IPC increase of 11.8% largely driven by new business growth in property and middle market lines and the renewal of long term policies as annual policies in primary casualty, partially offset by a large multi-year program in primary casualty written in the fourth quarter of 2010 with gross written premiums of $126.5 million.

NAPC increase of

25.0% largely driven by new business growth across all lines, including the new surety and construction initiatives, and improved pricing in all lines over the prior year including property, partially offset by lower multi-year transactions in excess casualty.

Professional decrease of 2.4% due to lower multi-year deals, lower new business in U.S. Professional partially offset by growth in new business in International and Select professional., and lower retention in US professional, partially offset by favorable retention in International.

- Specialty increase of 5.2% largely driven by new business growth in general aviation and specie lines and favorable amendments to prior year premium estimates in discontinued lines.

Foreign exchange rate movements also impacted our gross premiums written. When evaluated in local currency, our gross written premiums increased by 6.8%, compared to the 9.2% shown above.

Net Premiums Written

2012 vs. 2011: The increase of 9.8% resulted from the gross written premium increases outlined above together with a decrease in ceded written premiums. The decrease in ceded premiums primarily relates to:

- Decreased utilization of facultative reinsurance, primarily in IPC property, following the cancelation of a large general property program in 2011 and lower gross premiums written as a result of underwriting actions for business that did not meet our return requirements;

- Changes in the structure

and reinsurer participation of certain NAPC casualty and professional reinsurance treaties;

Lower cessions as a result of lower level of premiums subject to the Professional treaty; and

Favorable impact of foreign exchange rates.

Partially offsetting these were ceded premium increases as a result of:

Changes in the structure, protection layers and costs of certain property and IPC casualty reinsurance treaties;

A new reinsurance cover in NAPC programs; and

Additional reinstatement premiums in 2012 as a result of marine and Sandy losses.

2011 vs. 2010: The increase of 7.1% resulted from the gross premiums written increases described above partially offset by an increase in ceded premiums written of 16.7%. The increase in ceded premiums written primarily relates to:

- Increased utilization of facultative reinsurance, primarily in IPC property;
- Unfavorable impact of foreign exchange rates;

- Higher cost on certain excess of loss treaties and additional reinsurance placements on new business initatives; and

- Reinstatement premiums related to catastrophe, property and marine losses.

Net Premiums Earned

2012 vs. 2011: The increase of 7.1% primarily resulted from higher net written premiums earned in NAPC, Professional and Specialty and favorable amendments to certain prior year premium estimates, partially offset by lower production in IPC property as a result of underwriting actions for business that did not meet our return requirements and from ceded reinstatement premiums for marine and Sandy losses.

2011 vs. 2010: The increase of 3.8% primarily resulted from higher net written premiums earned through primary casualty, property, programs and middle markets and favorable foreign exchange impacts, offset by the ceded catastrophe, property and marine reinstatement premiums noted above and the earn-out of lower net premiums written in U.S. Professional and certain discontinued lines.

Net Losses and Loss Expenses

Combined Ratio

The following table presents the ratios for the Insurance segment:

				Percentage Point Change	
	2012	**2011**	**2010**	**2012 to 2011**	**2011 to 2010**
Loss and loss expense ratio	68.6 %	80.6 %	71.0 %	(12.0)	9.6
Acquisition expense ratio	12.8 %	12.6 %	11.8 %	0.2	0.8
Operating expense ratio	19.2 %	18.6 %	18.2 %	0.6	0.4
Underwriting expense ratio	32.0 %	31.2 %	30.0 %	0.8	1.2

Combined ratio	100.6 %	111.8 %	101.0 %	(11.2)	10.8

The loss and loss expense ratio includes net losses incurred for both the reported year and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year. The following table summarizes these components of the loss ratio for the Insurance segment for the years ended December 31, 2012, 2011 and 2010:

				Percentage Point Change	
	2012	**2011**	**2010**	**2012 to 2011**	**2011 to 2010**
Loss ratio	68.6 %	80.6 %	71.0 %	(12.0)	9.6
Prior year reserve development	3.5 %	2.0 %	3.6 %	1.5	(1.6)
Loss ratio excluding prior year development	72.1 %	82.6 %	74.6 %	(10.5)	8.0

Loss Ratio excluding prior year development

2012 vs. 2011: The 10.5 percentage point decrease in the loss ratio excluding prior year development was predominantly due to lower levels of catastrophe losses occurring in 2012. Losses net of reinsurance recoveries and reinstatement premiums related to natural catastrophe events were $132.1 million lower in 2012 as compared to 2011. For further details on catastrophe losses in 2012 and 2011, see Results of Operations Significant Items Affecting the Results of Operations 1) The impact of significant large loss events. Excluding prior year development, net catastrophe losses and related reinstatement premiums in both years, the loss ratio decreased by 6.4 points to 66.6%, due to large loss activity in the IPC and NAPC energy and property units in 2011, as well as business mix changes and underwriting improvements.

2011 vs. 2010: The 8.0 percentage point increase in the loss ratio excluding prior year development was predominantly due to the high levels of catastrophe losses occurring in 2011. Losses net of reinsurance recoveries and reinstatement premiums related to natural catastrophe events were $219.5 million higher in 2011 as compared to 2010. Excluding prior year development, net catastrophe losses and related

reinstatement premiums in both years, the loss ratio increased by 2.2 points from 2010 to 2011 due to higher large loss activity during 2011 in energy, property and marine businesses.

Prior Year Development

The following table summarizes the net (favorable) adverse prior year development by business group relating to the Insurance segment for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in millions)	**2012**	**2011**	**2010**
Property	$ (46,733)	$ (8,922)	$ (23,525)
Casualty	(61,633)	34,500	28,987
Professional	(106,368)	(87,520)	(118,552)
Specialty	(61,761)	(71,285)	(66,278)
Other (1)	136,428	56,711	51,957
Total	$ (140,067)	$ (76,516)	$ (127,411)

(1) Other includes excess and surplus, surety, structured indemnity and certain other discontinued lines.

For further information on the net favorable prior year reserve development for the years ended December 31, 2012, 2011 and 2010, see Item 8, Note 10 to the Consolidated Financial Statements, Losses and Loss Expenses.

Acquisition Costs and Operating Expenses

Underwriting Expense Ratio

2012 vs. 2011: The increase of 0.8 points was due to an increase in the operating expense ratio of 0.2 points combined with an increase in the acquisition expense ratio of 0.6 points, as follows:

Acquisition expense ratio increase largely from

the impact of reinstatement premiums and other earned premium adjustments, lower ceding income in IPC, NAPC and Professional and a change in the mix of direct business in Professional.

Operating expense ratio increase mainly due to higher compensation expenses resulting from higher variable compensation costs and certain severance costs in 2012.

2011 vs. 2010: The increase of 1.2 points was due to an increase in the acquisition expense ratio of 0.8 points combined with an increase in the operating expense ratio of 0.4 points, as follows:

Acquisition expense ratio increase primarily from a favorable adjustment to guaranty fund assessments in 2010, higher commissions and lower amounts of fee-based business in

U.S., Bermuda and International professional, as well as excess casualty and aerospace and the impact of the catastrophe, property and marine reinstatement premiums on the ratio in 2011.

Operating expense ratio increase mainly as a result of increased compensation costs from certain severance costs, higher number of employees, partially offset by lower variable compensation costs and unfavorable foreign exchange impacts.

Net Results   Structured Products

Net results from structured insurance products include certain structured indemnity contracts that are accounted for as deposit contracts.

2012 vs. 2011: The increase was mainly due to a lower interest expense as a result of an accretion rate adjustment recorded in the second quarter of 2012 based on changes in expected cash flows and payout patterns on certain structured indemnity contracts combined with an increase in net investment income as a result of a larger invested asset base.

2011 vs. 2010: The decrease reflects the overall run-off nature of this line of business combined with a change in the interest rate hedging strategy on one of the larger transactions during 2010.

Fee Income and Other

2012 vs. 2011: The increase was a result of higher income related to our loss prevention consulting services as well as lower expenses in professional lines related to the cost of an endorsement facility with National Indemnity Company, which ended in 2011. For further information about this facility, see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included herein.

2011 vs. 2010: The decrease was due to higher expenses related to our loss prevention consulting services partially offset by higher fee income in Specialty.

Reinsurance

As already outlined in Item 1, Business, the Reinsurance segment provides casualty, property risk, property catastrophe, marine, aviation and other specialty reinsurance on a global basis, with business being written on both a proportional and non-proportional treaty basis and also on a facultative basis. Our reinsurance operations are structured into geographical business groups: Bermuda, North America, International (Europe and Asia Pacific) and Latin America.

The following table summarizes the underwriting profit (loss) for the Reinsurance segment:

(U.S. dollars in thousands)	**2012**	**2011**	**2010**	**Percentage change**	
				2012 to 2011	**2011 to 2010**
Gross premiums written	$ 2,008,156	$ 2,073,619	$ 1,842,951	(3.2)%	12.5 %
Net premiums written	1,884,508	1,725,724	1,538,438	9.2 %	12.2 %
Net premiums earned	1,841,342	1,663,385	1,501,999	10.7 %	10.7 %
Net losses and loss expenses	(1,074,426)	(1,126,978)	(706,298)	(4.7)%	59.6 %
Acquisition costs	(368,172)	(324,128)	(321,008)	13.6 %	1.0 %
Operating expenses	(157,657)	(176,167)	(175,586)	(10.5)%	0.3 %
Underwriting profit (loss)	$ 241,087	$ 36,112	$ 299,107	NM *	NM *
Net results structured products	(15,882)	12,053	3,075	NM *	NM *
Net fee income and other	2,493	3,903	2,488	(36.1)%	56.9 %

* NM Not Meaningful

Gross Premiums Written

2012 vs. 2011: Gross premiums written decreased by 3.2%. The following is a summary of the premium movements by business group:

Bermuda there was premium growth through favorable property catastrophe and other property renewals with price, share, line and capacity increases and new business.

North America there was a decrease primarily as a result of changes in the structure of a U.S. agricultural program that renewed as reinsurance rather than as primary business, as well as a reduction in volume, shares and price for certain renewed property quota share and property excess of loss contracts, partially offset

by new business.

International premiums increased, attributable to casualty lines through significantly higher renewals and new business and increased property catastrophe shares and rates in Continental Europe.

Latin America there was a decline in premiums due to the non-renewal of certain significant property and surety treaties as a result of the re-underwriting of the business within this region.

Foreign exchange rate movements also impacted our gross premiums written. When evaluated in local currency, our gross written premiums decreased by 1.6%, compared to the 3.2% decrease shown above.

2011 vs. 2010: Gross premiums written increased by 12.5%. The following is a summary of the premium movements by business group:

Bermuda there was premium growth from new business in the year, growth in the property catastrophe

line through price and capacity increases and from natural catastrophe reinstatement premiums, partially offset by the non-renewal of certain property treaties.

North America there was premium growth mainly from the property line on a U.S. agricultural program due to rising commodity prices in 2011, partially offset by decreases in casualty due to current market conditions and the non-renewal of certain treaties.

International there was premium growth due to new motor and marine business, as well as positive amendments to prior year premium estimates.

Latin America there was a decline in premiums mainly due to the non-renewal of certain

significant
property
treaties.

Foreign exchange rate movements also impacted our gross premiums written. When evaluated in local currency, our gross written premiums increased by 8.9%, compared to the 12.5% increase shown above.

Net Premiums Written

2012 vs. 2011: The increase of 9.2% resulted from the International and Bermuda groups gross written premium increases described above coupled with a reduction in ceded written premiums in the North America business group. The decrease in ceded written premiums was mainly the result of the changes in the structure of a U.S. agricultural program, partially offset by higher prior period ceded reinstatement premiums in the International business group related to the 2011 Thailand flood loss.

2011 vs. 2010: The increase of 12.2% is a reflection of the overall growth in net premiums written in 2011 described above partially offset by an increase in ceded premiums written. The increase in ceded premiums written was mainly due to an increase in volume in 2011 associated with a U.S. agricultural program of which a significant portion was retroceded.

Net Premiums Earned

2012 vs. 2011: The increase of 10.7% is a reflection of the overall growth in net premiums written in recent quarters from the Bermuda and International businesses.

2011 vs. 2010: The increase of 10.7% is a reflection of the overall growth in net premiums written in 2011 combined with catastrophe loss related reinstatement premiums earned in 2011.

Net Losses and Loss Expenses

Combined Ratio

The following table presents the ratios for the Reinsurance segment:

				Percentage Point Change	
	2012	**2011**	**2010**	**2012 to 2011**	**2011 to 2010**
Loss and loss expense ratio	58.4 %	67.8 %	47.0 %	(9.4)	20.8
Acquisition expense ratio	20.0 %	19.5 %	21.4 %	0.5	(1.9)
Operating expense ratio	8.5 %	10.5 %	11.7 %	(2.0)	(1.2)
Underwriting expense ratio	28.5 %	30.0 %	33.1 %	(1.5)	(3.1)
Combined ratio	86.9 %	97.8 %	80.1 %	(10.9)	17.7

The loss and loss expense ratio includes net losses incurred for both the reported year and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year. The following table summarizes these components of the loss ratio for the Reinsurance segment for the years ended December 31, 2012,

2011 and 2010:

	2012	2011	2010	Percentage Point Change 2012 to 2011	2011 to 2010
Loss ratio	58.4 %	67.8 %	47.0 %	(9.4)	20.8
Prior year reserve development	9.5 %	12.5 %	16.4 %	(3.0)	(3.9)
Loss ratio excluding prior year development	67.9 %	80.3 %	63.4 %	(12.4)	16.9

Loss Ratio excluding prior year development

2012 vs. 2011: The 12.4 percentage point decrease in the loss ratio excluding prior year development was predominantly due to lower levels of catastrophe losses occurring in 2012. Losses net of reinsurance recoveries and reinstatement premiums related to natural catastrophe events were $164.7 million lower in 2012 as compared to 2011. For further details on catastrophe losses in 2012 and 2011, see Results of Operations Significant Items Affecting the Results of Operations 1) The impact of significant large loss events. Excluding prior year development, net catastrophe losses and related reinstatement premiums in both years, the loss ratio decreased by 1.0 points to 54.1%, due mainly to business mix changes.

2011 vs. 2010: The 16.9 percentage point increase in the loss ratio excluding prior year development was predominantly due to higher levels of catastrophe losses occurring in 2011, noted above. Losses net of reinsurance recoveries and reinstatement premiums related to natural catastrophe events were $247.3 million higher in 2011 compared to 2010. Excluding prior year development, net catastrophe losses and related reinstatement premiums in both years, the loss ratio increased by 2.3 points from 2010 to 2011 mainly due to higher levels of large loss events in U.S. property including a deterioration in the performance of a large U.S. agricultural program, higher attritional losses and business mix changes.

Prior Year Development

The following table summarizes the net (favorable) adverse prior year development by line of business relating to the reinsurance segment for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands)		**2012**		**2011**		**2010**
Property and other short-tail lines	$	(107,613)	$	(64,267)	$	(145,768)
Casualty and other		(68,215)		(144,084)		(99,683)
Total	$	(175,828)	$	(208,351)	$	(245,451)

For further information on the net favorable prior year reserve development for the years ended December 31, 2012, 2011 and 2010, see Item 8, Note 10 to the Consolidated Financial Statements, Losses and Loss Expenses.

Acquisition Costs and Operating Expenses

Underwriting Expense Ratio

2012 vs. 2011: The decrease of 1.5 percentage points was due to a reduction in the operating expense ratio of 2.0 points partially offset by an increase in the acquisition expense ratio of 0.5 points, as follows:

Operating
expense ratio
decreased
with reduced
compensation
costs due to
decreased
headcount and

lower professional fees, while net earned premiums increased compared to 2011.

Acquisition expense ratio increase the acquisition expense ratio was largely in line with 2011, with a slight increase from Latin America due to a favorable movement on sliding scale commissions in the prior year.

2011 vs. 2010: The decrease of 3.1 percentage points was due to a decrease in the acquisition expense ratio of 1.9 points combined with a decrease in the operating expense ratio of 1.2 points, as follows:

Acquisition expense ratio decrease primarily due to a U.S. agricultural program, where fees received were higher and profit commissions paid were lower in 2011.

Operating expense ratio decrease mainly as a result of lower compensation

costs in 2011, partially offset by increased information technology expenses associated with certain strategic initiatives.

Net Results   Structured Products

Net results from structured reinsurance products include certain structured indemnity contracts that are accounted for as deposit contracts.

2012 vs. 2011: The decrease relates to a higher interest expense recorded in the second quarter of 2012, due to an accretion rate adjustment from changes in expected cash flows and payout patterns on one

of the larger structured indemnity contracts combined with lower net investment income reflecting lower investment yields and the run-off nature of this line of business.

2011 vs. 2010: The increase relates to a higher interest expense recorded in the third quarter of 2010, due to an accretion rate adjustment from changes in expected cash flows and payout patterns on one of the larger structured indemnity contracts.

Fee Income and Other

2012 vs. 2011: The decrease was a result of fees earned in Latin America on some treaties which were not renewed.

2011 vs. 2010: The increase was due in part to the amendment to the sales proceeds for the renewal rights of the European life, accident and health business, resulting in a charge for the prior year period. In addition, fees earned in Latin America increased during 2011 due to the extension in duration for some treaties.

Life Operations

The following table summarizes the contribution from the Life operations segment, which has been in run-off since 2009:

(U.S. dollars in thousands)	**2012**	**2011**	**2010**	**Percentage change**	
				2012 to 2011	**2011 to 2010**
Gross premiums written	$ 355,754	$ 394,555	$ 411,938	(9.8)%	(4.2)%
Net premiums written	324,432	362,362	382,075	(10.5)%	(5.2)%
Net premiums earned	324,459	363,018	382,924	(10.6)%	(5.2)%
Claims and policy benefits	(486,198)	(535,074)	(513,833)	(9.1)%	4.1 %
Acquisition costs	(41,093)	(40,318)	(49,104)	1.9 %	(17.9)%
Operating expenses	(9,336)	(9,311)	(10,470)	0.3 %	(11.1)%
Net investment income	299,442	318,061	313,172	(5.9)%	1.6 %
Net fee income and other	426	219	249	94.5 %	(12.0)%
Realized gains (losses) on investments	(21,003)	(89,999)	(54,444)	(76.7)%	65.3 %
Contribution from Life operations	$ 66,697	$ 6,596	$ 68,494	NM *	(90.4)%

* NM Not Meaningful

Gross Premiums Written

The following table is an analysis of the Life operations gross premiums written, net premiums written and net premiums earned for the year ended December 31, 2012 and 2011:

(U.S. dollars in thousands)	**2012**			**2011**		
	Gross Premiums Written	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Annuity	$ 155,255	$ 126,912	$ 126,912	$ 161,800	$ 132,232	$ 132,232
Other Life	200,499	197,520	197,547	232,755	230,130	230,786
Total	$ 355,754	$ 324,432	$ 324,459	$ 394,555	$ 362,362	$ 363,018

2012 vs. 2011: The 9.8% decrease was driven predominantly by the Other Life business and was in line with the run-off expectations, as well as being impacted by unfavorable foreign exchange movements. Gross premiums written relating to annuity business and ceded premiums written also decreased due to foreign exchange movements.

2011 vs. 2010: The 4.2% decrease was mainly from the Other Life business and was in line with the run-off expectations following the recapture of a number of term assurance treaties during the first and fourth quarters of 2010, partially offset by favorable foreign exchange movements. Gross premiums written relating to annuity business increased due to favorable foreign exchange rate movements. Ceded premiums written increased due to foreign exchange movements.

Net Premiums Written and Net Premiums Earned

2012 vs. 2011: The 10.5% decrease in net premium written and the 10.6% decrease in net earned premiums were consistent with the movements in total gross premiums written and the reduction in ceded written premiums already noted.

2011 vs. 2010: The 5.2% decrease in both net written and net earned premiums resulted from the gross written premium decreases outlined above, partially offset by an increase in ceded written premiums due to foreign exchange movements.

Claims and Policy Benefits

2012 vs. 2011: The 9.1% decrease was due to the run-off nature of the Life operations business, combined with favorable foreign exchange impacts during 2012.

2011 vs. 2010: The 4.1% increase was primarily due to adverse foreign exchange impacts and reserve increases during the year combined with 2010 experiencing reserve releases on recaptured treaties that were not repeated in 2011.

Acquisition Costs

2012 vs. 2011: The 1.9% increase was largely due to a revision to profit commission estimates on the short-term life, accident and health business more than offsetting lower acquisition costs on the term and critical illness business.

2011 vs. 2010: The 17.9% decrease was largely due to the recaptured treaties in 2010 and run-off expectations.

Operating Expenses

2012 vs. 2011: Operating expenses were largely flat year on year; however, higher compensation expenses resulting from higher variable compensation costs in 2012, was offset by a reduction in information technology expenses.

2011 vs. 2010: The 11.1% decrease was mainly due to lower compensation expenses as a result of severance costs in 2010 following the decision to place the Life operations business into run-off.

Net Investment Income Life Operations

Net investment income is included in the calculation of contribution from Life operations, as it relates to income earned on portfolios of separately identified and managed life investment assets and other allocated assets.

2012 vs. 2011: The 5.9% decrease was due to unfavorable foreign exchange movements, lower investment yields and a lower invested asset base, reflecting the run-off nature of the Life operations business.

2011 vs. 2010: The 1.6% increase was primarily due to positive foreign exchange impact, but was broadly in line with expected returns in underlying currencies.

Investment Performance

We manage our fixed income portfolio in accordance with investment guidelines approved by the RFC. The following is a summary of the investment portfolio returns, which are calculated by dividing the sum of gross investment income or net income from investment affiliates, realized gains (losses) and unrealized

gains (losses) by the average market value of each portfolio, for the years ended December 31, 2012 and 2011 of the fixed income portfolio and non-fixed income portfolios:

	2012 (1)	2011 (1)
Total Return on Investments	6.7 %	5.5 %
P&C fixed income portfolio	5.5 %	4.6 %
Life fixed income portfolio	11.5 %	9.1 %
Other Portfolios (2)		
Alternative portfolio (3)	5.6 %	3.4 %
Equity portfolio	15.5 %	(6.4)%
High-Yield fixed income portfolio	9.6 %	1.5 %

(1) The performance of investment portfolios is measured on a local currency basis and is not annualized. For aggregate performance calculation, respective local currency balances are translated to U.S. dollars at quarter end rates to calculate composite portfolio results.

(2) Performance on Other Portfolios is included in

the Total Return on Investments.

(3) Performance on the alternative portfolio reflects the year ended November 30, 2012 and 2011, respectively.

Investment Activities

The following table illustrates the net investment income from P&C operations, net income from investment fund affiliates, net realized (losses) gains on investments and net realized and unrealized gains (losses) on investment and other derivative instruments for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands)	**2012**	**2011**	**2010**	**Percentage change**	
				2012 to 2011	**2011 to 2010**
Net investment income P&C operations (1)	$ 712,906	$ 819,708	$ 884,866	$ (13.0)%	(7.4)%
Net income (loss) from investment fund affiliates (2)	58,504	26,253	51,102	122.8 %	(48.6)%
Net realized gains (losses) on investments	14,098	(188,359)	(270,803)	NM *	(30.4)%
Net realized and unrealized gains (losses) on investment and other derivative instruments (3)	5,221	(10,738)	(33,843)	NM *	(68.3)%

(1) Net investment income relating to P&C operations

includes the net investment income related to the net results from structured products.

(2) The Company generally records the income related to alternative fund affiliates on a one-month lag and the private investment fund affiliates on a three-month lag based upon the availability of the information provided by the investees.

(3) For a summary of realized and unrealized gains and losses on all derivative instruments, see Item 1, Note 14, Derivative Instruments, to the Consolidated Financial Statements included

herein.

* NM Not Meaningful

Net Investment Income P&C Operations

2012 vs. 2011: The decrease of 13.0% was primarily due to decreasing portfolio yields and cash outflows from the investment portfolio. Overall, portfolio yields have decreased due to declining interest rates across our major jurisdictions.

2011 vs. 2010: The decrease of 7.4% was due to decreasing portfolio yields and cash outflows from the investment portfolio. Overall, portfolio yields have decreased due to declining interest rates across our major jurisdictions.

Net Income (Loss) from Investment Fund Affiliates

Net income from investment fund affiliates includes earnings from our investments in closed-end investment funds and partnerships and similar vehicles that are accounted for under the equity method.

2012 vs. 2011: The increase was attributable to better performance from both alternative fund affiliates and private fund affiliates. Capital markets were moderately more supportive of our fund affiliates

investment strategies in 2012 vs. 2011, and our alternative fund affiliate managers in particular navigated market volatility better in 2012 as against the prior year.

2011 vs. 2010: The decrease of 48.6% was attributable to weaker performance from our alternative and private investment portfolios given difficult market conditions in 2011. Performance in alternative and private funds in 2011 was challenged by volatile capital markets and the generally weaker returns to risk assets during 2011 as compared to the prior year.

Net Realized Gains and Losses on Investments and Other-than-Temporary Declines in the Value of Investments

Net Realized Gains and Losses on Investments

Net realized gains on investments of $14.1 million included the following:

Net realized gains of $94.8 million resulted from sales transactions primarily from a repositioning of the Agency RMBS portfolio and sales of equity and non-U.S. Sovereign Government securities.

Realized losses of approximately $80.7 million related to the write-down of certain of the Company s AFS investments. The significant components of the net impairment charges were:

$48.7 million for structured

securities, principally non-Agency RMBS, where we determined that the likely recovery on these securities was below the carrying value and, accordingly, recorded an impairment of the securities to the discounted value of the cash flows expected to be received on these securities.

$19.1 million related to medium term notes backed primarily by European investment grade credit. On certain notes, management concluded that expected future returns on the underlying assets were not sufficient to support the previously reported amortized cost. We also adjusted the

estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.

$3.7 million related to certain equities as the holdings were in a loss position for more than 11 months.

$5.3 million related to currency losses primarily arising on Swiss franc and U.K. sterling denominated securities held in U.S. dollar portfolios.

Net realized losses on investments in 2011 included net realized losses of $160.2 million related to the write-down of certain of our fixed income, equity and other investments with respect to which we determined that there was an other-than-temporary decline in the value of those investments, as well as $28.2 million of net realized losses from sales of investments principally on European financials and non-Agency RMBS, partially offset by gains on Agency RMBS and Government and Government Related and Supported securities.

Net Realized and Unrealized Gains and Losses on Derivative Instruments

Net realized and unrealized gains on derivatives of $5.2 million in the year ended December 31, 2012 resulted from our investment strategy to manage interest rate risk, foreign exchange risk and credit risk, and to replicate permitted investments. For a further discussion, see Item 1, Note 14, Derivative Instruments, to the Consolidated Financial Statements included herein.

Other Revenues and Expenses

The following table sets forth our other revenues and expenses for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands)	2012	2011	2010	Percentage Change	
				2012 to 2011	2011 to 2010
Net income (loss) from operating affiliates (1)	$ 55,810	$ 76,786	$ 121,372	(27.3)%	(36.7)%
Exchange gains (losses)	(10,546)	40,640	10,161	NM *	NM *
Corporate operating expenses	(204,500)	(160,596)	(92,544)	27.3 %	73.5 %
Interest expense (2)	(105,766)	(154,084)	(159,118)	(31.4)%	(3.2)%
Impairment of goodwill		(429,020)		NM *	NM *
Loss on settlement of guarantee			(23,500)	NM *	NM *
Income tax expense	(34,028)	(59,707)	(162,737)	(43.0)%	(63.3)%

(1) We generally record the income related to certain operating affiliates on a three-month lag based upon the availability of the information provided by the investees.

(2) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

* NM Not meaningful

Net Income (Loss) from Operating Affiliates

The following table sets forth the net income (loss) from operating affiliates for the years ended December 31, 2012, 2011 and 2010:

(U.S. dollars in thousands)	**2012**	**2011**	**2010**	**Percentage Change**	
				2012 to 2011	**2011 to 2010**
Net income (loss) from financial operating affiliates	$	$ (1,018)	$ 53,031	(100.0)%	(101.9)%
Net income (loss) from investment manager affiliates	28,777	56,913	40,180	(49.4)%	41.6 %
Net income (loss) from strategic operating affiliates	27,033	20,891	28,161	29.4 %	(25.8)%
Total	$ 55,810	$ 76,786	$ 121,372	(27.3)%	(36.7)%

Net Income (Loss) from Financial Operating Affiliates

The financial operating affiliate loss in 2011 is wholly attributable to a write down in the value of one investment following a restructuring.

Net Income from Investment Manager Affiliates

2012 vs. 2011: 2012 net income from investment manager affiliates was solid, but was significantly lower than 2011 results. The significant decrease in 2012 compared to 2011 results was due to the positive impact of the sale of our ownership stake in Finisterre in 2011 and especially strong performance by the investment manager affiliates (including Finisterre prior to the closing of the sale transaction). There were no sales of any stakes in 2012, and

performance was solid but not especially strong during the period.

2011 vs. 2010: The substantial increase in 2011 as compared to 2010 reflected the positive impact of the sale of our ownership stake in Finisterre, strong results from certain investment manager affiliates in 2011 and, the achievement of results that surpassed certain performance fee hurdles by various funds under management in the second quarter of 2011, compared to solid broad-based results in 2010.

Net Income from Strategic Operating Affiliates

2012 vs. 2011: The net income from strategic operating affiliates was generally in line with 2011. The year on year increase of 29.4% was primarily due to losses from an insurance affiliate catastrophe bond fund in 2011.

2011 vs. 2010: The decrease of 25.8% was due to losses from an insurance affiliate catastrophe bond fund in 2011 combined with higher income in 2010 from our Brazilian joint venture ITAÚ XL Seguros Corporativos S.A. (ITAU), which was sold during the second quarter of 2010.

Foreign Exchange Gains (Losses)

The foreign exchange losses in 2012 were a result of an overall weakening of the value of the U.S. dollar against the Company s major currency exposures, which include the U.K. sterling, the Euro and the Swiss franc. In 2011, foreign exchange gains were produced as a result of a stronger U.S. dollar against the U.K. sterling, the Brazilian real and the Swiss franc, which more than offset losses that were driven by a stronger Australian dollar. In 2010, foreign exchange gains were marginal as a result of a limited overall movement in the value of the U.S. dollar.

Corporate Expenses

2012 vs. 2011: The increase of 27.3% was a result of performance-based compensation costs and certain strategic corporate initiatives taking place in 2012.

2011 vs. 2010: The increase of 73.5% was primarily as a result of certain strategic corporate initiatives taking place in 2011.

Interest Expense

Interest expense includes costs related to the Company s debt and collateral facilities and does not include deposit liability accretion which is included in Net investment results structured products.

2012 vs. 2011: The decrease of 31.4% was a result of the overall reduction in our debt following the repayment at maturity on January 15, 2012 of $600 million 6.5% XLCFE Notes and the purchase and retirement of the $575 million 8.25% Senior Notes in August 2011, partially offset by the issuance of $400 million 5.75% Senior Notes in September 2011.

2011 vs. 2010: The decrease of 3.2% was primarily as a result of the overall reduction in the Company s debt following the purchase and retirement of the $500 million 8.25% Senior Notes in August 2011 and the sale of $400 million 5.75% Senior Notes in September 2011.

For further information about these debt financing transactions see Item 8, Note 13, Notes Payable and Debt Financing Arrangements, to the Consolidated Financial Statements included herein.

Impairment of Goodwill

2012 vs. 2011: There were no goodwill impairments recorded during 2012. In 2011, a non-cash goodwill impairment charge of $429.0 million was recorded representing a write-off of all goodwill associated with the Insurance segment. For further information, see Item 8, Note 8 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets, and see further discussion under Critical Accounting Policies and Estimates.

Loss on Settlement of Guarantee

2010: As part of the continued management of certain legacy financial businesses, which were put into runoff in 2008, in the second quarter of 2010, management was successful in commuting our exposure to EIB. For further information on the loss on settlement of this guarantee, see Item 8, Note 17(h) to the Consolidated Financial Statements, Financial and Other Guarantee Exposures.

Income Tax Expense

2012 vs. 2011: The tax charge of $34.0 million recognized in 2012 was lower than 2011 mainly as a result of the recognition in 2012 of a tax benefit of $24.5m arising on the release of valuation allowances held against capital loss carry-forwards that were utilized to offset 2012 realized gains and other discrete tax benefit items in 2012 which totaled $19.8 million. The 2011 tax charge was impacted by a number of items including the adverse global distribution of profits and losses as detailed below.

2011 vs. 2010: The tax charge of $59.7 million recognized in 2011 was lower than 2010 mainly as a result of a benefit of $11.9 million arising as a result of a change in an overseas tax rule adopted in the

quarter ended June 30, 2011. We incurred a tax charge in 2011 notwithstanding reporting net losses due to the distribution of operating profits across the organization and the impact of internal reinsurance. In addition, net profits were recorded in certain jurisdictions due to the distribution of prior year development. A tax benefit of $11.5 million was recognized in the fourth quarter of 2011 in respect of the non-cash goodwill impairment charge of $429.0 million.

Balance Sheet Analysis

Investments

We seek to generate book value growth and investment income from investment activities through the total returns on our investment portfolio. Our investment strategy, (see Item 1. Business Investments,) strives to balance investment returns against market and credit risk. Our overall investment portfolio is structured to take into account a number of variables including liability profile, local regulatory requirements, business needs, collateral management and risk tolerance.

At December 31, 2012 and 2011, total investments, cash and cash equivalents, accrued investment income and net receivable/(payable) for investments sold/(purchased) were approximately $36.9 billion and $35.9 billion, respectively. The following table summarizes the composition of our invested assets at December 31, 2012 and 2011:

(U.S. dollars in thousands)	**2012** Carrying Value (1)	**2012** Percent of Total	**2011** Carrying Value (1)	**2011** Percent of Total
Cash and cash equivalents	$ 2,618,378	7.1 %	$ 3,825,125	10.7 %
Net receivable/ (payable) for investments sold/ (purchased)	(86,110)	(0.2)%	1,233	0.0 %
Accrued investment income	342,778	0.9 %	331,758	0.9 %
Short-term investments	322,703	0.9 %	359,063	1.0 %
Fixed maturities AFS:				
U.S. Government and Government-Related/Supported (2)	2,034,617	5.5 %	1,990,983	5.5 %
Corporate Financials (3) (4) (5)	3,240,399	8.8 %	3,038,398	8.5 %
Corporate Non Financials (4)	7,241,601	19.6 %	7,070,224	19.7 %
RMBS Agency	5,255,493	14.3 %	5,379,406	15.0 %
RMBS Non-Agency	647,733	1.8 %	641,815	1.8 %
CMBS	1,077,251	2.9 %	974,835	2.8 %
CDO	709,816	1.9 %	658,602	1.8 %
Other asset-backed securities (5)	1,470,711	4.0 %	1,340,249	3.7 %
U.S. States and political subdivisions of the States	1,911,017	5.2 %	1,797,378	5.0 %
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/ Supported (2)	4,258,282	11.6 %	3,298,135	9.2 %
Total fixed maturities AFS	$ 27,846,920	75.6 %	$ 26,190,025	73.0 %

Fixed maturities HTM:						
U.S. Government and Government-Related/Supported (2)		10,788	0.0 %		10,399	0.0 %
Corporate Financials (3) (4) (5)		266,565	0.7 %		305,122	0.9 %
Corporate Non Financials (4)		1,158,755	3.1 %		985,087	2.7 %
RMBS Non-Agency		83,205	0.2 %		80,955	0.2 %
CMBS		12,751	0.0 %			0.0 %
Other asset-backed securities (5)		222,340	0.6 %		288,741	0.8 %
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)		1,060,043	2.9 %		998,674	2.8 %
Total fixed maturities HTM	$	2,814,447	7.5 %	$	2,668,978	7.4 %
Equity securities (6)		649,359	1.8 %		468,197	1.3 %
Investments in affiliates		1,126,875	3.1 %		1,052,729	2.9 %
Other investments		1,219,879	3.3 %		985,262	2.8 %
Total investments and cash and cash equivalents	$	36,855,229	100.0 %	$	35,882,370	100.0 %

(1) Carrying values represents the fair value for AFS fixed maturities and amortized cost for HTM securities.

(2) U.S. Government and Government-Related/Supported and Non U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported include government-related securities with an amortized cost of $1,912.7 million and $1,878.3 million and fair value of $1,988.5 million and $1,915.6 million at December 31, 2012 and 2011, respectively, and U.S. Agencies with an amortized cost of $404.3 million and $494.0 million and fair value of $446.7 million and $541.2 million at December 31, 2012 and 2011, respectively.

(3) Included in Corporate Financials are gross unrealized losses of $23.7 million and $108.8 million on Tier One and Upper Tier Two securities of financial institutions (Hybrids) with fair values of $308.5 million and $386.1 million at December 31, 2012 and 2011, respectively, as well as gross unrealized losses of $11.8 million and $70.1 million on subordinated debt (including lower Tier Two securities) with fair values of $649.4 million and $701.3 million at December 31, 2012 and 2011, respectively.

(4) Included within Corporate are certain floating rate medium term notes supported primarily by pools of European

investment grade credit with varying degrees of leverage. The notes have a fair value of $194.3 million and $266.0 million and an amortized cost of $194.8 million and $297.7 million at December 31, 2012 and 2011, respectively. These securities have been allocated ratings based on the average credit rating of the underlying asset pools backing the notes. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(5) At December 31, 2012, Covered Bonds within Fixed maturities AFS with a carrying value of $647.1 million and Covered Bonds within Fixed maturities HTM with a carrying value of $8.6 million have been included within Other asset-backed securities to align our classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012. At December 31, 2011, Covered Bonds within Fixed maturities AFS with a carrying value of $353.9 million and Covered Bonds within Fixed maturities HTM with a carrying value of $7.7 million were reclassified from Corporate to Other asset-backed securities to conform to the current period presentation.

(6) Included within Equity securities are investments in fixed income funds of $101.9 million and $91.6 million at December 31, 2012 and 2011, respectively.

We review our corporate debt investments on a regular basis to consider their concentration, credit quality and compliance with established guidelines. At both December 31, 2012 and 2011, the average credit quality of our total fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net receivable/(payable) for investment sold/(purchased)) was Aa2/AA . Included in the table below are the credit ratings of the fixed income portfolio excluding operating cash at December 31, 2012 and 2011:

(U.S. dollars in millions) **Investments by Credit Rating (1)(2)**	**December 31, 2012** Carrying Value		**December 31, 2011** Carrying Value	
	Carrying Value	**Percent of Total**	**Carrying Value**	**Percent of Total**
AAA	$ 15,631	47.0 %	$ 16,276	51.1 %
AA	5,954	17.8 %	5,266	16.6 %
A	7,436	22.3 %	7,098	22.3 %
BBB	3,317	10.0 %	2,418	7.6 %
BB and below	934	2.8 %	718	2.3 %
Not rated	19	0.1 %	39	0.1 %
Total	$ 33,291	100.0 %	$ 31,815	100.0 %

(1) At December 31, 2012 and 2011, $194.3 million and $266.0 million or 0.6% and 0.8% of the fixed income portfolio, respectively, represents medium term notes rated at the average credit rating of the underlying asset pools backing the notes.

(2) The credit rating for each asset

reflected above was principally determined based on the weighted average rating of the individual securities from Standard & Poor s, Moody s Investors Service and Fitch Ratings (when available). U.S. Agency debt and related mortgage backed securities, whether with implicit or explicit government support, reflect the credit quality rating of the U.S. government for the purpose of these calculations.

Gross and Net Unrealized Gains and Losses on Investments

We had gross unrealized losses totaling $282.8 million on 1,223 securities out of a total of 7,331 AFS securities held at December 31, 2012 and $2.7 million on 5 securities out of a total of 206 HTM securities, which we consider to be temporarily impaired or with respect to which reflects non-credit losses on OTTI. Individual security positions comprising this balance have been evaluated by management, in conjunction with our investment managers, to determine the severity of these impairments and whether they should be considered other-than-temporary.

Gross unrealized losses can be attributed to the following significant drivers:

- gross unrealized losses of $87.2 million related to the P&C portfolio of Core CDO holdings (defined by us as investments in non-subprime CDOs), which consisted primarily of collateralized loan obligations (CLOs) and had a fair value of $709.8 million at December 31, 2012.

- gross unrealized losses of $76.9 million related to the P&C portfolio of Non-Agency RMBS holdings (which consists of our holdings of sub-prime Non-Agency RMBS, second liens, ABS CDOs with sub-prime collateral, Alt-A and Prime RMBS), which had a fair value of

$741.4 million at December 31, 2012. We incurred realized losses, consisting of charges for OTTI and realized losses from sales, of approximately $1.4 billion since the beginning of 2007 through December 31, 2012 on these asset classes.

gross unrealized losses of $55.3 million related to our Life operations investment portfolio, which had a fair value of $6.9 billion at December 31, 2012. Of these gross unrealized losses, $22.6 million related to $1.2 billion of exposures to corporate financial institutions, including $266.7 million related to Tier One and Upper Tier Two securities.

At December 31, 2012, this portfolio had

an average interest rate duration of 8.8 years, primarily denominated in U.K. sterling and Euros. As a result of the long duration, significant gross losses have arisen as the fair values of these securities are more sensitive to prevailing government interest rates and credit spreads. This portfolio is generally matched to corresponding long duration liabilities. A hypothetical parallel increase in interest rates and credit spreads of 50 and 25 basis points, respectively, would increase the unrealized losses related to this portfolio at December 31, 2012 by approximately $307.9 million and $119.4 million, respectively, on both the

AFS and HTM holdings in the Life operations investment portfolio.

Given the long-term nature of the Life operations investment portfolio, the level of credit spreads on financial institutions at December 31, 2012 relative to historical averages within the U.K. and Euro-zone and our liquidity needs at December 31, 2012, we believe that these assets will continue to be held until such time as they mature, or credit spreads on financial institutions revert to levels more consistent with historical averages.

gross unrealized losses of $51.3 million related to the corporate holdings within our non-Life fixed

income portfolios, which had a fair value of $8.2 billion at December 31, 2012. Of the gross unrealized losses, $21.6 million relate to financial institutions. In addition, $5.2 million relate to medium term notes primarily supported by pools of European investment grade credit with varying degrees of leverage. These had a fair value of $194.3 million at December 31, 2012. Management believes that expected cash flows from these bonds over the expected holding period will be sufficient to support the remaining reported amortized cost.

The following shows the security type and length of time that AFS securities were in a continual gross unrealized loss position at December 31, 2012:

December 31, 2012

Security Type and Length of Time in a Continual Unrealized Loss Position *(U.S. dollars in thousands)*	**Amount of Unrealized Loss**	**Fair Value of Securities in an Unrealized Loss Position**
Fixed Maturities and Short-Term Investments		
Less than 6 months	$ (15,663)	$ 1,843,335
At least 6 months but less than 12 months	(6,761)	163,750
At least 12 months but less than 2 years	(19,862)	193,930
2 years and over	(240,464)	1,839,561
Total	$ (282,750)	$ 4,040,576
Equities		
Less than 6 months	$ (62)	$ 615
At least 6 months but less than 12 months		
Total	$ (62)	$ 615

The following is the maturity profile of the AFS fixed income securities that were in a continual gross unrealized loss position at December 31, 2012:

Maturity profile in years of AFS fixed income securities in a gross unrealized loss position *(U.S. dollars in thousands)*	**December 31, 2012** Amount of Unrealized Loss	Fair Value of Securities in an Unrealized Loss Position
Less than 1 year remaining	$ (14,133)	$ 319,874
At least 1 year but less than 5 years remaining (1)	(43,621)	1,030,581
At least 5 years but less than 10 years remaining (1)	(13,823)	327,528
At least 10 years but less than 20 years remaining (1)	(16,936)	199,971
At least 20 years or more remaining (1)	(4,955)	101,543
RMBS Agency	(5,535)	589,958
RMBS Non-Agency	(76,868)	455,229
CMBS	(4,288)	116,479
CDO	(87,156)	694,594
Other asset-backed securities	(15,435)	204,819
Total	$ (282,750)	$ 4,040,576

(1) Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments senior to the common and preferred equities of the financial institutions, are allocated based on the call date unless such security is not called on

such date, in which case it is allocated the final or longest expected maturity. Medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage are allocated on contractual maturity.

The following is the maturity profile of the HTM fixed income securities that were in a gross unrealized loss position at December 31, 2012:

Maturity profile in years of HTM fixed income securities in a gross unrealized loss position *(U.S. dollars in thousands)*	**December 31, 2012** Amount of Unrealized Loss	Fair Value of Securities in an Unrealized Loss Position
Less than 1 year remaining	$ (1)	$ 3,692
At least 5 years but less than 10 years remaining	(31)	876
At least 10 years but less than 20 years remaining	(127)	11,321
At least 20 years or more remaining	(2,355)	22,202
Other asset-backed securities	(167)	1,239
Total	$ (2,681)	$ 39,330

Factors considered in determining that additional OTTI charges were not warranted include management s consideration of current and near term liquidity needs along with other available sources of liquidity, and in certain instances an evaluation of the factors and time necessary for recovery. For further information, see Item 1, Note 5, Investments, to the Consolidated Financial Statements included herein.

As noted in Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included herein, the determination of the amount of OTTI varies by investment type and is based upon management s periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and

assessments are revised as conditions change and new information becomes available. Management considers a wide range of factors about the securities and uses its best judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for near-term recovery. Inherent in management s evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Management updates its evaluations regularly and reflects additional impairments in net income as determinations are made. Management s determination of the amount of the impairment taken on investments is highly subjective and could adversely impact our results of operations. There can be no assurance that we have accurately assessed the level of OTTI taken and reflected in our financial statements. Furthermore, additional impairments may need to be taken in the future. Historical trends may not be indicative of future impairments.

Levels of write down or OTTI are also impacted by our assessment of the intent to sell securities that have declined in value prior to recovery. If, due to changes in circumstances, we determine to reposition or realign portions of the portfolio and we determine not to hold certain securities in an unrealized loss position to recovery, we will incur OTTI charges, which could be significant.

Gross Unrealized Gains and Losses

Management, in our assessment of whether securities in a gross unrealized loss position are temporarily impaired, considers the significance of the impairments. At December 31, 2012, we had corporate financial sector securities with gross unrealized losses of $44.5 million and we did not hold any corporate securities which had a cumulative fair value decline of greater than 50% of amortized cost.

At December 31, 2012, we had structured securities with gross unrealized losses of $76.9 million on non-Agency RMBS, $87.2 million on Core CDOs and $4.3 million on CMBS holdings. These securities included gross unrealized losses of $26.0 million, which had a fair value of $10.3 million and a cumulative fair value decline of greater than 50% of amortized cost. All of these are mortgage and asset-backed securities. We have evaluated each of these securities in conjunction with our investment manager service providers and believe it is more likely than not that the issuer will be able to fund sufficient principal and interest payments to support the current amortized cost.

Net Unrealized Gains and Losses   Corporate Financial Sector Securities

At December 31, 2012, approximately $1.2 billion of our $3.5 billion in corporate financial sector securities was held in the portfolio supporting our Life operations investment portfolio representing 20.4% of the net unrealized gains on this asset class. The assets associated with that business are more heavily weighted towards longer term securities from financial institutions, including a significant portion of our Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments senior to the common and preferred equity of the financial institutions. Financials held in the Life operations investment portfolio accounted for $22.8 million of our net unrealized loss at December 31, 2012. At December 31, 2012, approximately 42.3% of the overall sensitivity to interest rate risk and 35.5% of the overall sensitivity to credit risk was related to the Life operations investment portfolio, despite this accounting for only 20.3% of the fixed income portfolio.

Net Unrealized Gains and Losses   Structured Securities

The following table details the current exposures to structured securities excluding Agency RMBS within our fixed income portfolio as well as the current net unrealized (loss) gain position at December 31, 2012 and December 31, 2011:

	December 31, 2012			December 31, 2011		
(U.S. dollars in thousands) **RMBS Non-Agency:**	**Carrying Value**	**Percent of Fixed Income Portfolio**	**Net Unrealized Gain (Loss)**	**Carrying Value**	**Percent of Fixed Income Portfolio**	**Net Unrealized Gain (Loss)**
Sub-prime first lien mortgages	$ 306,795	1.0 %	$ (35,893)	$ 295,498	1.0 %	$ (136,981)
Alt-A mortgages	136,965	0.4 %	(1,267)	114,506	0.4 %	(39,659)
	28,661	0.1 %	2,912	26,461	0.1 %	(6,076)

Second lien mortgages (including sub-prime second lien mortgages)									
Prime RMBS		139,974	0.5 %		1,452		158,264	0.5 %		(26,328)
Other assets		118,543	0.4 %		2,060		128,041	0.4 %		5,790
Total exposure to Non-Agency RMBS		730,938	2.4 %		(30,736)		722,770	2.4 %		(203,254)
CMBS		1,090,002	3.6 %		66,457		974,835	3.3 %		47,152
Core CDOs (1)		709,816	2.3 %		(75,183)		662,949	2.3 %		(185,611)
Other Structured		1,693,051	5.5 %		44,228		1,635,162	5.6 %		7,732
Total Non-Agency Structured Securities	$	4,223,807	13.8 %	$	4,766	$	3,995,716	13.6 %	$	(333,981)

(1) We define Core CDOs as investments in non-subprime collateralized debt obligations, which primarily consisted of CLOs.

At December 31, 2012, our sub-prime, Alt-A and CDO exposures had adequate underlying asset characteristics and we believe at such date that the current amortized cost levels were at or below the discounted cash flow value of the holdings, based on an analysis of subordination levels relative to current expectations of prepayment rates, probability of default and loss severity in the event of default. Approximately $289.8 million of our Non-Agency RMBS were downgraded during the year ended December 31, 2012. However, 45.4% of our holdings in Non-Agency RMBS remained rated investment grade at December 31, 2012.

Refer to Significant Items Affecting the Results of Operations above for further discussion surrounding the impact of credit market movements on our investment portfolio.

European Sovereign Debt Crisis

The ongoing global financial crisis has led to the deterioration of economies globally, as sovereign governments have reacted to the crisis by further increasing public expenditures in order to provide stimulus and security, which has created significant budgetary shortfalls. Several key nations within the European Union particularly Greece, Italy, Ireland, Portugal and Spain (GIIPS) have suffered a high level of fiscal distress and economic vulnerability due to overreliance on external credit sources and imprudent borrowing and other monetary practices. This has raised doubts within the global financial community as to whether these sovereign nations will remain able to service their own debt obligations both at a national and local level and as to whether the Euro will remain the currency for the European Union.

Our primary exposure to this European sovereign debt crisis is from direct investment in fixed maturity securities issued by GIIPS national and local governments, as well as from fixed maturity securities issued by certain financial and non-financial corporate entities operating within GIIPS. During the year we actively reduced our exposures to these securities. We continue to monitor our financial exposure to this crisis, and continually assess the impact of a potential default by any of GIIPS on their respective debt issuances, including the associated impact on non-sovereign entities in these five nations in the event of such a default. In reaction to mounting pressure from financial markets, the European Union and its members implemented several key initiatives in 2012 that helped alleviate concern over Europe s long term debt sustainability. These included 1) ongoing measures to reduce deficits and lower debt to sustainable levels, 2) pan-European emergency funding vehicles such as the European Financial Stability Fund (EFSF) and later the European Stability Mechanism (ESM) to support new bond issuance, 3) the promise of Outright Monetary Transactions from the ECB to support near-term peripheral yields, and 4) implementation of Long Term Repo Operations to provide financial institution liquidity. These events helped calm credit markets and led to a string of successful bond auctions and lower sovereign yields for the GIIPS nations, although these programs have not been finalized or implemented. Yet despite these positive developments Europe faces growing social unrest over its austerity programs and a challenging economic environment with public sector spending eclipsing private sector

growth. National elections scheduled in Italy for the first quarter of the year and Germany in the third or fourth quarter of the year adds to the uncertainty and depending on the outcome could lead to changes in Europe s approach to the sovereign debt crisis. In addition, Greece, following a 2012 restructuring continues to need monetary support and remains at risk of default, further restructuring and/or exit from the Eurozone.

We currently have no unfunded investment exposures or commitments to either sovereign or non-sovereign entities within these EU nations. We do invest in various alternative and private investment funds that from time to time may invest in securities or investments related to these five EU nations. Currently, these are not material exposures.

The following is an analysis of our AFS and HTM fixed maturity investment exposures related to GIIPS at December 31, 2012 and December 31, 2011 and the contractual maturities of these securities. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(U.S. dollars in thousands) **Fixed maturities GIIPS AFS**	**December 31, 2012 Amortized Cost**	**December 31, 2012 Fair Value**	**December 31, 2011 Amortized Cost**	**December 31, 2011 Fair Value**
Government and government related National Governments	$ 5,350	$ 4,896	$ 6,601	$ 5,927
Government and government related Local Governments				
Corporate investments Financial Institutions	372	374	6,001	4,626
Corporate investments Non-Financial Institutions	57,032	57,720	138,834	131,890
Structured Securities (1)	7,942	9,618	22,172	19,417
Total fixed maturities GIIPS AFS	$ 70,696	$ 72,608	$ 173,608	$ 161,860
Due less than one year	$ 5,392	$ 5,431	$ 13,824	$ 14,028
Due after 1 through 5 years	16,144	15,744	32,992	31,050
Due after 5 through 10 years	14,924	15,111	72,988	70,651
Due after 10 years	34,236	36,322	53,804	46,131
	$ 70,696	$ 72,608	$ 173,608	$ 161,860
Fixed maturities GIIPS HTM				
Government and government related National Governments	$ 12,237	$ 10,518	$ 11,738	$ 8,739
Government and government related Local Governments			9,360	7,649
Corporate investments Non-Financial Institutions	59,757	60,199	72,782	65,380
Structured Securities (1)				
Total fixed maturities GIIPS HTM	$ 71,994	$ 70,717	$ 93,880	$ 81,768
Due less than one year	$	$	$ 6,264	$ 6,233
Due after 1 through 5 years	4,285	4,332	4,199	4,110
Due after 5 through 10 years	12,372	12,937	20,705	18,260
Due after 10 years	55,337	53,448	62,712	53,165
Total	$ 71,994	$ 70,717	$ 93,880	$ 81,768

(1) During 2012, Covered Bonds have been included within Other asset-backed securities under Structured Securities to align our classification to market indices. Prior periods have been reclassified to conform to current period presentation.

The following table details the gross and net unrealized (loss) gain position at December 31, 2012 relating to GIIPS:

(U.S. dollars in thousands)	December 31, 2012					
	Greece	**Italy**	**Ireland**	**Portugal**	**Spain**	**TOTAL**
Gross Unrealized (Losses) GIIPS						
Government and government related National Governments	$	$ (2,174)	$	$	$	$ (2,174)
Government and government related Local Governments						
Corporate investments Financial Institutions						
Corporate investments Non-Financial		(1,775)			(301)	(2,076)

Institutions						
Structured Securities (1)			(43)			(43)
Total gross unrealized gains (losses) relating to GIIPS	$	$ (3,949)	$ (43)	$	$ (301)	$ (4,293)
Net Unrealized Gains (Losses) GIIPS						
Government and government related National Governments	$	$ (454)	$	$	$	$ (454)
Government and government related Local Governments						
Corporate investments Financial Institutions			2			2
Corporate investments Non-Financial Institutions	276	(1,019)			1,431	688
Structured Securities (1)			1,676			1,676
Total net unrealized gains (losses) relating to GIIPS	$ 276	$ (1,473)	$ 1,678	$	$ 1,431	$ 1,912

(1)

Covered Bonds have been included within Other asset-backed securities under Structured Securities to align our classification to market indices. Prior periods have been reclassified to conform to current period presentation.

In addition to the direct investment portfolio considerations discussed above, as an international (re)insurance company, European credit exposures may exist for us within unpaid losses and loss expenses recoverable and reinsurance balances receivable. For further details on these balances including the names of the our most significant reinsurance counterparties, see Item 8, Note 9, Reinsurance, to the Consolidated Financial Statements included herein. Other sources of potential exposure to European credit issues may exist within certain lines of insurance or reinsurance business written (including but not limited to lines such as surety, business interruption, and political risk), or within underlying investments held in securitized financial instruments or in structured transactions in which we have an interest. We consider these potential exposures as part of our ongoing enterprise risk management processes.

Fair Value Measurements of Assets and Liabilities

As described in Item 1, Note 3, Fair Value Measurements, to the Consolidated Financial Statements included herein, effective January 1, 2008, we adopted the authoritative guidance on fair value measurements and, accordingly, have provided required disclosures by level within the fair value hierarchy of our assets and liabilities that are carried at fair value. As defined in the hierarchy, those assets and liabilities categorized as Level 3 have valuations determined using unobservable inputs. Unobservable inputs may include the entity s own assumptions about market participant assumptions, applied to a modeled valuation, however, this is not the case with respect to our Level 3 assets and liabilities. The vast majority of the assets and liabilities classified as Level 3 are made up of securities for which we obtained values from brokers where significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, sufficient information regarding the specific inputs utilized by the broker were not obtained to support a Level 2 classification or we utilized internal valuation models.

Controls over Valuation of Financial Instruments

We perform regular reviews of the prices received from our third party valuation sources to assess whether the prices represent a reasonable estimate of the fair value. This process is completed by investment and accounting personnel who are independent of those responsible for obtaining the valuations. The approaches we take include, but are not limited to, annual reviews of the controls of the external parties responsible for sourcing valuations that are subjected to automated tolerance checks, quarterly reviews of the valuation sources and dates, comparison of executed sales prices to prior valuations, regular deep dives on a sample of securities across our major asset classes and monthly reconciliations between the valuations provided by our external parties and valuations provided by our third party investment managers at a portfolio level.

In addition, we assess the effectiveness of valuation controls performed by external parties responsible for sourcing appropriate valuations from third parties on our behalf. The approaches taken by these external parties to gain comfort include, but are not limited to, comparing valuations between external sources, completing recurring reviews of third party pricing services methodologies and reviewing controls of the third party service providers to support the completeness and accuracy of the prices received. Where broker quotes are the primary source of the valuations, sufficient information regarding the specific inputs utilized by the brokers is generally not available to support a Level 2 classification. We obtain the majority of broker quoted values from third party investment managers who perform independent verifications of these valuations using pricing matrices based upon information gathered by market traders. In addition, for the majority of these securities, we compare the broker quotes to independent valuations obtained from third party pricing vendors, which may also consist of broker quotes, to assess if the prices received represent a reasonable estimate of the fair value.

Valuation Methodology of Level 3 Assets and Liabilities

Refer to Item 1, Note 3, Fair Value Measurements, of the Consolidated Financial Statements included herein, for a description of the valuation methodology utilized to value Level 3 assets and liabilities, how the valuation methodology is validated as well as further details associated with various assets classified as Level 3. At December 31, 2012, we did not have any liabilities that were carried at fair value based on Level 3 inputs other than derivative

instruments in a liability position at December 31, 2012.

Fair Value of Level 3 Assets and Liabilities

At December 31, 2012, the fair value of Level 3 assets and liabilities as a percentage of our total assets and liabilities that are carried at fair value was as follows:

(U.S. dollars in thousands)	Total Assets and Liabilities Carried at Fair Value at December 31, 2012	Fair Value of Level 3 Assets and Liabilities	Level 3 Assets and Liabilities as a Percentage of Total Assets and Liabilities Carried at Fair Value, by Class
Assets			
Fixed maturities, at fair value			
U.S. Government and Government Agency-Related/Supported	$ 2,034,617	$	0.0 %
Corporate (1)	10,482,000	30,098	0.3 %
RMBS Agency	5,255,493	32,005	0.6 %
RMBS Non-Agency	647,733	116	0.0 %
CMBS	1,077,251	25,347	2.4 %
CDO	709,816	701,736	98.9 %
Other asset-backed securities (1)	1,470,711	18,128	1.2 %
U.S. States and political subdivisions of the States	1,911,017		0.0 %
Non-U.S. Sovereign Government, Supranational and Government-Related	4,258,282		0.0 %
Total Fixed maturities, at fair value	$ 27,846,920	$ 807,430	2.9 %
Equity securities, at fair value	649,359		0.0 %
Short-term investments, at fair value	322,703		0.0 %
Total investments available for sale	$ 28,818,982	$ 807,430	2.8 %
Cash equivalents (2)	2,004,668		0.0 %
Other investments (3)	907,755	115,272	12.7 %
Other assets (4)	29,967		0.0 %
Total assets carried at fair value	$ 31,761,372	$ 922,702	2.9 %
Liabilities			
Financial instruments sold, but not yet purchased (5)	$ 26,235	$	0.0 %
Other liabilities (6)	59,623	36,247	60.8 %

Total liabilities carried at fair value	$ 85,858	$ 36,247	42.2 %

(1) During 2012, Covered Bonds previously included as Corporate securities are now classified as Other asset-backed securities to align our classification to market indices. At December 31, 2012, these securities had a fair value of $647.1 million.

(2) Cash equivalents balances subject to fair value measurements include certificates of deposit and money market funds.

(3) The Other investments balance excludes certain structured transactions including certain investments in

project finance transactions and a payment obligation (for further information, see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included herein) that has provided liquidity financing to a structured credit vehicle as a part of a third party medium term note facility. These Other investments are carried at amortized cost that totaled $312.1 million at December 31, 2012 and $323.7 million at December 31, 2011.

(4) Other assets include derivative instruments, reported on a gross basis.

(5) Financial instruments sold, but not yet purchased are included within Payable for investments

purchased on the balance sheet.

(6) Other liabilities include derivative instruments, reported on a gross basis.

At December 31, 2012, our Level 3 assets represented approximately 2.9% of assets that are measured at fair value and less than 2% of total assets. Our Level 3 liabilities represented approximately 42.2% of liabilities that are measured at fair value and less than 1% of total liabilities at December 31, 2012.

Changes in the Fair Value of Level 3 Assets and Liabilities

See Item 1, Note 3, Fair Value Measurements, to the Consolidated Financial Statements included herein, for an analysis of the change in fair value of Level 3 Assets and Liabilities.

Unpaid Losses and Loss Expenses

We establish reserves to provide for estimated claims, the general expenses of administering the claims adjustment process and losses incurred but not reported. These reserves are calculated using actuarial and

other reserving techniques to project the estimated ultimate net liability for losses and loss expenses. Our reserving practices and the establishment of any particular reserve reflects our judgment concerning sound financial practice and do not represent any admission of liability with respect to any claims made against us.

Unpaid losses and loss expenses totaled $20.5 billion and $20.6 billion at December 31, 2012 and 2011, respectively. The table below represents a reconciliation of our P&C unpaid losses and loss expenses for the year ended December 31, 2012:

(U.S. dollars in thousands)	**Gross unpaid losses and loss expenses**	**Unpaid losses and loss expenses recoverable**	**Net unpaid losses and loss expenses**
Balance at December 31, 2011	$ 20,613,901	$ (3,629,928)	$ 16,983,973
Losses and loss expenses incurred	4,376,337	(610,855)	3,765,482
Losses and loss expenses paid/recovered	(4,673,997)	890,755	(3,783,242)
Foreign exchange and other	167,880	(11,674)	156,206
Balance at December 31, 2012	$ 20,484,121	$ (3,361,702)	$ 17,122,419

While we regularly review the adequacy of established reserves for unpaid losses and loss expenses, no assurance can be given that actual claims made and payments related thereto will not be in excess of the amounts reserved. In the future, if such reserves develop adversely, such deficiency would have a negative impact on future results of operations. For further discussion, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates 1) Unpaid Loss and Loss Expenses and Unpaid Loss and Loss Expenses Recoverable, and Item 8, Note 10, Losses and Loss Expenses, to the Consolidated Financial Statements included herein.

Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable

In the normal course of business, we seek to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. While reinsurance agreements are designed to limit our losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve our ultimate liability to the insureds. Accordingly, the losses and loss expense reserves on the balance sheet represent our total unpaid gross losses. Unpaid losses and loss expense recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

The table below presents our net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable as follows:

(U.S. dollars in thousands)	**2012**	**2011**
Reinsurance balances receivable	$ 113,023	$ 263,877
Reinsurance recoverable on future policy benefits	20,399	25,020
Reinsurance recoverable on unpaid losses and loss expenses	3,415,038	3,685,260
Bad debt reserve on unpaid losses and loss expenses recoverable and reinsurance balances receivable	(107,931)	(99,192)

Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable	$	3,440,529	$	3,874,965

We have credit risk should any of our reinsurers be unable or unwilling to settle amounts due. Of the $3.4 billion total unpaid losses and loss expenses recoverable and reinsurance balances receivable at December 31, 2012, one individual reinsurer accounted for greater than 15% of the total. We are the beneficiary of letters of credit, trust accounts and funds withheld in the aggregate amount of $1.7 billion at December 31, 2012, collateralizing reinsurance recoverables with respect to certain reinsurers. The provision for uncollectible reinsurance is required principally due to the failure of reinsurers to indemnify us primarily because of disputes under reinsurance contracts and insolvencies. At December 31, 2012 and 2011, we had a reserve for potential non-recoveries from reinsurers of $108.0 million and $99.2 million, respectively.

Approximately 91% of the total unpaid loss and loss expense recoverable and reinsurance balances receivable (net of collateral held) outstanding at December 31, 2012 was due from reinsurers with a

financial strength rating of A or better. The following is an analysis of the total recoverable and reinsurance balances receivable at December 31, 2012, by reinsurers owing 3% or more of such total:

Name of Reinsurer	Reinsurer Financial Strength Rating	% of Total
Munich Reinsurance Company	AA-/Stable	25.4%
Swiss Reinsurance Company	AA-/Stable	11.0%
Lloyd s Syndicate	A+/Stable	8.0%
Swiss Re Europe S.A.	AA-/Stable	5.5%
Transatlantic Reinsurance Company	A+/Stable	4.0%

The following table sets forth the ratings profile of the reinsurers that support the unpaid loss and loss expense recoverable and reinsurance balances receivable:

Reinsurer Financial Strength Rating	% of Total
AAA	1.2 %
AA	53.1 %
A	37.1 %
BBB	0.3 %
BB and below	0.0 %
Captives	6.1 %
Not Rated	0.2 %
Other	2.0 %
Total	100.0 %

Liquidity and Capital Resources

Liquidity is a measure of our ability to generate sufficient cash flows to meet the short and long-term cash requirements of our business operations. As a global insurance and reinsurance company, one of our principal responsibilities to clients is to ensure that we have ready access to funds with which to settle large unforeseen claims. We would generally expect that positive cash flow from operations (underwriting activities and investment income) will be sufficient to cover cash outflows under most future loss scenarios. However, there is a possibility that unforeseen demands could be placed on us due to extraordinary events and, as such, our liquidity needs may change. Such events include, among other things: several significant catastrophes occurring in a relatively short period of time resulting in material incurred losses; rating agency downgrades of our core insurance and reinsurance subsidiaries that would require posting of collateral in connection with our letter of credit and revolving credit facilities; return of unearned premiums and/or the settlement of derivative transactions and large scale uncollectible reinsurance recoverables on paid losses (as a result of coverage disputes, reinsurers credit problems or decreases in the value of collateral supporting reinsurance recoverables). Any one or a combination of such events may cause a liquidity strain for us. In addition, a liquidity strain could also occur in an illiquid market, such as that which was experienced in 2008. Investments that may be used to meet liquidity needs in the event of a liquidity strain may not be liquid, due to inactive markets or may have to be sold at a significant loss as a result of depressed prices. Because each subsidiary focuses on a more limited number of specific product lines than is collectively available from the consolidated group

of companies, the mix of business tends to be less diverse at the subsidiary level. As a result, the probability of a liquidity strain, as described above, may be greater for individual subsidiaries than when liquidity is assessed on a consolidated basis. If such a liquidity strain were to occur in a subsidiary, XL-Ireland may be required to contribute capital to the particular subsidiary and/or curtail dividends from the subsidiary to support holding company operations, which may be difficult given that XL-Ireland is a holding company and has limited liquidity.

A downgrade below A of our principal insurance and reinsurance subsidiaries by either S&P or A.M. Best, which is two notches below the current S&P financial strength rating of A (Positive) and the A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger cancelation provisions in a significant amount of our assumed reinsurance agreements and may potentially require us to return unearned premiums to cedants. In addition, due to collateral posting requirements under our letter of credit and revolving credit facilities, such a downgrade may require the posting of cash collateral in support of

certain in use portions of these facilities. Specifically, a downgrade below A by A.M. Best would constitute an event of default under our three largest credit facilities and may trigger such collateral requirements. In certain limited instances, such downgrades may require that we return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1A, Risk Factors, included herein.

Holding Company Liquidity

As holding companies, XL-Ireland and XL-Cayman have no operations of their own and their assets consist primarily of investments in subsidiaries. XL-Ireland s principal uses of liquidity are ordinary share-related transactions, including dividend payments to holders of its ordinary shares as well as share buybacks, capital investments in its subsidiaries and certain corporate operating expenses. XL-Cayman s principal uses of liquidity are preference share related transactions, including dividend payments to its preference shareholders as well as preference share buybacks from time to time, interest and principal payments on debt and certain corporate operating expenses.

XL-Ireland s and XL-Cayman s future cash flows largely depend on the availability of dividends or other permissible payments from subsidiaries to make principal and interest payments on debt, to pay operating expenses and ordinary and preferred shareholder dividends, to make capital investments in subsidiaries and to pay other obligations that may arise from time to time. The ability of our subsidiaries to pay dividends to us or return capital from shareholders equity is limited by applicable laws and regulations of the various jurisdictions in which we operate, certain additional required regulatory approvals and by financial covenants contained in our letters of credit and revolving credit facilities. The payment of dividends to the holding companies by the Company s principal operating subsidiaries is regulated under the laws of various jurisdictions including Bermuda, the U.K., Ireland and Switzerland, certain insurance statutes of various states in the United States in which the principal operating subsidiaries are licensed to transact business, the other jurisdictions where the Company has regulated subsidiaries and by regulations of the Society of Lloyd s. See Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements for further discussion and details regarding the dividend capacity of our major operating subsidiaries. See also Item 1A, Risk Factors Our holding company structure and certain regulatory and other constraints affect our ability to pay dividends, make payments on our debt securities and make other payments, included herein. No assurance can be given that our subsidiaries will pay dividends in the future to XL-Ireland and XL-Cayman.

Under Irish law, share premium was required to be converted to distributable reserves for XL-Ireland to pay cash dividends and redeem and buyback shares following the Redomestication. On July 23, 2010, the Irish High Court approved XL-Ireland s conversion of share premium to $5.0 billion of distributable reserves, subject to the completion of certain formalities under Irish Company law. These formalities were completed in early August 2010. At December 31, 2012, XL-Ireland had $3.6 billion in distributable reserves.

At December 31, 2012, XL-Ireland and XL-Cayman held cash and investments, net of liabilities associated with cash sweeping arrangements, of $11.0 million and $1.4 billion, respectively, compared to $1.6 million and $2.0 billion, respectively, at December 31, 2011.

All of our outstanding debt at December 31, 2012 was issued by XL-Cayman. At December 31, 2011, all outstanding debt was issued by XL-Cayman except for the $600 million par value 6.5% Guaranteed Senior Notes (the XLCFE Notes) which were issued by XL Capital Finance (Europe) plc (XLCFE) and were repaid at maturity on January 15, 2012. Both XL-Cayman and XLCFE are 100% owned subsidiaries of XL-Ireland. The XLCFE Notes were fully and unconditionally guaranteed by XL Company Switzerland GmbH. XL-Cayman s outstanding debt is fully and unconditionally guaranteed by XL-Ireland. The ability of XL- Cayman, like that of the Company s, to obtain funds from its subsidiaries to satisfy any of its obligations under guarantees is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which we operate, including, among others, Bermuda, the United States, Ireland, Switzerland and the U.K. For details of the required statutory capital and surplus for our principal operating subsidiaries, see Note 23, Statutory Financial Data.

See also the Consolidated Statements of Cash Flows in Item 8, Financial Statements included herein.

Sources of Liquidity

At December 31, 2012, on a consolidated basis we had cash and cash equivalents of approximately $2.6 billion as compared to approximately $3.8 billion at December 31, 2011. The reduction was primarily due to the accumulation of cash in 2011 to fund the repayment of the XLCFE Notes in January 2012. We have three main sources of cash flows those provided by operations, investing activities and financing activities:

Total cash provided by (used in): *(U.S. dollars in thousands)*	**2012**	**2011**	**2010**
Operating activities	$ 1,056,106	$ 327,202	$ 594,756
Investing activities	(942,593)	832,103	261,481
Financing activities	(1,344,753)	(358,716)	(1,473,343)
Effects of exchange rate changes on foreign currency cash	24,493	1,668	(3,723)

Operating Cash Flows

Historically, cash receipts from operations, consisting of premiums and investment income, generally have provided sufficient funds to pay losses as well as operating expenses of our subsidiaries and to fund dividends to XL-Ireland. Cash receipts from operations are generally derived from the receipt of investment income on our investment portfolio as well as the net receipt of premiums less claims and expenses related to our underwriting activities in our P&C and Life operations. Our operating subsidiaries provide liquidity in that premiums are generally received months or even years before losses are paid under the policies related to such premiums. Premiums and acquisition expenses are settled based on terms of trade as stipulated by an underwriting contract, and generally are received within the first year of inception of a policy when the premium is written, but can be up to three years on certain reinsurance business assumed. Operating expenses are generally paid within a year of being incurred. Claims, especially for casualty business, may take a much longer time before they are reported and ultimately settled, requiring the establishment of reserves for unpaid losses and loss expenses. Therefore, the amount of claims paid in any one year is not necessarily related to the amount of net losses incurred, as reported in the consolidated statement of income.

During the year ended December 31, 2012, net cash flows provided by operating activities were $1.1 billion compared to net cash flows provided by operating activities of $327.2 million for the same period in 2011. The operating cash increase was primarily due to the increase in net income in the year ended December 31, 2012 compared to the same period in 2011.

Investing Cash Flows

Generally, positive cash flow from operations and financing activities is invested in our investment portfolio, including affiliates or the acquisition of subsidiaries.

Net cash used in investing activities was $942.6 million in the year ended December 31, 2012 compared to net cash provided of $832.1 million for the same period in 2011. These cash flows were associated with the normal purchase and sale of portfolio investments.

Certain of our invested assets are held in trust and pledged in support of insurance and reinsurance liabilities as well as credit facilities. Such pledges are largely required by our operating subsidiaries that are non-admitted under U.S. state insurance regulations, in order for the U.S. cedant to receive statutory credit for reinsurance. Also, certain deposit liabilities and annuity contracts require the use of pledged assets. As further described in Item 1, Note 5, Investments Pledged Assets, to the Consolidated Financial Statements included herein, certain assets of the investment portfolio

are pledged as collateral under our letter of credit facilities. At December 31, 2012 and December 31, 2011, we had $16.9 billion and $17.2 billion in pledged assets, respectively.

Financing Cash Flows

Cash flows related to financing activities include ordinary and preferred share related transactions, the payment of dividends, the issue or repayment of preference ordinary shares and deposit liability transactions. During the year ended December 31, 2012, net cash flows used in financing activities were

$1.3 billion. Net cash outflows related primarily to the buybacks of XL-Ireland s ordinary shares and repayment of debt as described below.

On February 27, 2012, we announced that the XL-Ireland Board of Directors approved the February 2012 Program, authorizing the purchase of up to $750 million of our ordinary shares. This authorization replaced the approximately $190 million remaining under the share buyback program that was authorized in November 2010 as described in further detail in Item 8, Note 18, Share Capital, to the Consolidated Financial Statements herein. During 2012, we purchased and canceled 18.3 million ordinary shares under the February 2012 Program for $401.6 million. At December 31, 2012, $348.4 million remained available for purchase under this program. Between January 1 and February 22, 2013 we purchased and canceled an additional 3.8 million shares for $98.4 million. All share buybacks were carried out by way of redemption in accordance with Irish law and XL-Ireland s constitutional documents. All shares so redeemed were canceled upon redemption. On February 22, 2013, we announced that the XL-Ireland Board of Directors approved a new share buyback program, authorizing the purchase of up to $850 million of our ordinary shares. This replaced the approximately $250 million remaining under the February 2012 Program.

On January 15, 2012, the $600 million principal amount outstanding on the XLCFE Notes, which were issued by XLCFE, was repaid at maturity. For further detail, see Item 1, Note 13, Notes Payable and Debt Financing Arrangements, to the Consolidated Financial Statements included herein.

In addition, we maintain credit facilities that provide liquidity. Details of these facilities are described below in Capital Resources.

Capital Resources

At December 31, 2012 and December 31, 2011, we had total shareholders equity of $11.9 billion and $10.8 billion, respectively. In addition to ordinary share capital, we depend on external sources of financing to support its underwriting activities in the form of:

a. debt;

b. preference shares;

c. letter of credit facilities and other sources of collateral; and

d. revolving credit facilities.

In particular, we require, among other things:

sufficient capital to maintain its financial strength and credit ratings, as issued by several ratings agencies, at levels considered

necessary by management to enable our key operating subsidiaries to compete;

sufficient capital to enable its regulated subsidiaries to meet the regulatory capital levels required in the United States, the U.K., Bermuda, Ireland, Switzerland and other key markets;

letters of credit and other forms of collateral that are required to be posted or deposited, as the case may be, by our operating subsidiaries that are non-admitted under U.S. state insurance regulations in order for the U.S. cedant to receive statutory credit for reinsurance. We also uses letters of

credit to support its operations at Lloyd s; and

revolving credit to meet short-term liquidity needs.

The following risks are associated with our requirement to renew its credit facilities:

the credit available from banks may be reduced resulting in our need to pledge its investment portfolio to customers. This could result in a lower investment yield;

we may be downgraded by one or more rating agencies, which could materially and negatively impact our business, financial condition, results of operations and/or liquidity; and

the volume of business

that our subsidiaries that are not admitted in the United States are able to transact could be reduced if we are unable to renew its letter of credit facilities at an appropriate amount.

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Consolidation within the banking industry may result in the aggregate amount of credit provided to us being reduced. We attempt to mitigate this risk by identifying and/or selecting additional banks that can participate in the credit facilities upon renewal. See Item 1A, Risk Factors.

The following table summarizes the components of our current capital resources as follows:

(U.S. dollars in thousands)	2012	2011
Series D preference ordinary shares	$ 345,000	$ 345,000
Series E preference ordinary shares	999,500	999,500
Ordinary share capital	10,510,072	9,411,658
Total ordinary and non-controlling interests capital	$ 11,854,572	$ 10,756,158
Notes payable and debt	1,666,103	2,264,618
Total capital	$ 13,520,675	$ 13,020,776

Ordinary Share Capital

The following table reconciles the opening and closing ordinary share capital positions as follows:

(U.S. dollars in thousands)	December 31, 2012	December 31, 2011
Ordinary shareholders equity beginning of period	$ 9,411,658	$ 9,597,473
Net income (loss) attributable to XL Group plc	651,134	(474,760)
Share buybacks	(402,930)	(667,022)
Share issues	6,946	573,015
Ordinary share dividends	(135,572)	(138,978)
Change in accumulated other comprehensive income	936,947	482,269
Share based compensation and other	41,889	39,661
Ordinary shareholders equity end of period	$ 10,510,072	$ 9,411,658

Debt

The following tables present our debt under outstanding securities and lenders commitments at December 31, 2012:

(U.S. dollars in thousands)	Commitment/ Debt	In Use/ Outstanding	Year of Expiry	Payments Due by Period: Less than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years
4-year	$ 1,000,000	$	2015	$	$	$	$

revolver							
5.25% Senior Notes	600,000	598,424	2014		600,000		
5.75% Senior Notes	400,000	396,230	2021				400,000
6.375% Senior Notes	350,000	348,701	2024				350,000
6.25% Senior Notes	325,000	322,748	2027				325,000
	$ 2,675,000	$ 1,666,103		$	$ 600,000	$	$ 1,075,000
Adjustment to carrying value impact of fair value hedges		$ 6,675					
Total		$ 1,672,778					

In Use/Outstanding data represent December 31, 2012 accreted values. Payments Due by Period data represents ultimate redemption values.

In addition, see Item 1, Note 13, Notes Payable and Debt and Financing Arrangements, to the Consolidated Financial Statements included herein for further information.

At December 31, 2012, banks and investors provided us with $2.7 billion of debt capacity, of which $1.7 billion was utilized. These facilities consist of:

- a revolving credit facility of $1.0 billion.
- senior unsecured notes of approximately $1.7 billion. These notes require XL-Cayman to pay a fixed rate of interest during their terms. At December 31,

2012, there were four outstanding issues of senior unsecured notes:

$600 million senior notes due September 2014, with a fixed coupon of 5.25%. The security is publicly traded. The notes were issued in two tranches of $300 million aggregate principal amount each one tranche at 99.432% and the other at 98.419% with aggregate net proceeds of $590.9 million. Related expenses of the offering amounted to $2.7 million.

$400 million senior notes due October 2021, with a fixed coupon of

5.75%. The security is publicly traded. The notes were issued at 100.0% and net proceeds were $395.7 million. Related expenses of the offering amounted to $4.3 million.

$350 million senior notes due November 2024, with a fixed coupon of 6.375%. The security is publicly traded. The notes were issued at 100.0% and net proceeds were $347.8 million. Related expenses of the offering amounted to $2.2 million.

$325 million of senior notes due May 2027, with a fixed coupon of 6.25%. The security is publicly traded. The notes were issued at 99.805% and net proceeds were $321.9 million. Related expenses of the offering amounted to $2.5 million.

Preferred Shares and Non-controlling Interest in Equity of Consolidated Subsidiaries

Neither the Redeemable Series C preference ordinary shares nor the Series E preference ordinary shares were transferred from XL-Cayman to XL-Ireland in the Redomestication. Accordingly, subsequent to July 1, 2010, these instruments represent non-controlling interests in our consolidated financial statements and have been reclassified to non-controlling interest in equity of consolidated subsidiaries. See Item 8, Note 1, General, to the Consolidated Financial Statements included herein for further information. During the third quarter of 2011, all Redeemable Series C preference ordinary shares were purchased and canceled. At December 31, 2012, the face value of the outstanding Series E preference ordinary shares was $999.5 million.

On October 15, 2011, XL-Cayman issued 350,000 non-cumulative Series D Preference Ordinary Shares for $350 million of cash and liquid investments that were held in a trust account that was part of the Stoneheath facility. Holders of the Stoneheath securities received one Series D Preference Ordinary Share in exchange for each Stoneheath security.

On December 5, 2011, we repurchased 5,000 of the outstanding Series D Preference Ordinary Shares with a liquidation preference value of $5.0 million for $3.7 million, including accrued dividends. As a result of these repurchases, we recorded a gain of approximately $1.3 million through Non-controlling interests in the Consolidated Statement of Income in the fourth quarter of 2011. At both December 31, 2012 and December 31, 2011, the face value of the outstanding Series D Preference Ordinary Shares was $345.0 million.

Letter of Credit Facilities and other sources of collateral

At December 31, 2012, we had five letter of credit (LOC) facilities in place with total availability of $4.0 billion, of which $1.8 billion was utilized.

(U.S. dollars in thousands)	**Commitment/ Debt**	**In Use/ Outstanding**	**Year of Expiry**	**Amount of Commitment Expiration by Period** Less than 1 Year	1 to 3 Years	3 to 5 Years	
LOC Facility (1)	$ 1,000,000	$ 832,576	$ 2014	$	$ 832,576	$	$
LOC Facility (2) (3)	1,350,000	116,664	2015			116,664	
LOC Facility (3)	650,000	380,312	2015			380,312	
LOC Facility	750,000	303,458	Continuous				
LOC Facility	250,000	124,240	Continuous				
Five LOC facilities	$ 4,000,000	$ 1,757,250		$	$ 832,576	$ 496,976	$

(1) We have the option to increase the size of the March 2011 Credit Agreement by an additional $500 million.

(2) This letter of credit facility includes $1.0 billion that is also included in the 4-year

revolver listed under Debt.

(3) We have the option to increase the size of the facilities under the December 2011 Credit Agreements by an additional $500 million across both such facilities.

In 2011, we (i) entered into three new credit agreements, which provided for an aggregate amount of outstanding letters of credit and revolving credit loans up to $3 billion, subject to certain options to increase the size of the facilities, and (ii) terminated the five-year credit agreement dated June 21, 2007 (the 2007 Credit Agreement), which had provided for an aggregate amount of outstanding letters of credit and revolving credit loans up to $4 billion.

On March 25, 2011, we entered into a secured credit agreement (the March 2011 Credit Agreement) that currently provides for the issuance of letters of credit in an aggregate amount of up to $1 billion with the option to increase the size of the facility by an additional $500 million. Concurrent with the effectiveness of the March 2011 Credit Agreement, the commitments of the lenders under the 2007 Credit Agreement were reduced from $4 billion to $3 billion. The commitments under the March 2011 Credit Agreement will expire on, and the credit facility is available on a continuous basis until, the earlier of (i) March 25, 2014 and (ii) the date of termination in whole of the commitments upon an optional termination or reduction of the commitments by the account parties or upon an event of default.

On December 9, 2011, we entered into (i) a new secured credit agreement (the December 2011 Secured Credit Agreement) and (ii) a new unsecured credit agreement (the December 2011 Unsecured Credit Agreement and together with the December 2011 Secured Credit Agreement, the December 2011 Credit Agreements). In connection with the December 2011 Credit Agreements, the 2007 Credit Agreement was terminated. The March 2011 Credit Agreement continues in force, but was amended to conform certain of its terms to those of the December 2011 Secured Credit Agreement.

The 2007 Credit Agreement had provided for letters of credit and for revolving credit loans of up to $750 million with the aggregate amount of outstanding letters of credit and revolving credit loans thereunder not to exceed $3 billion. At the time at which it was terminated and the December 2011 Credit Agreements became effective, there were no outstanding revolving credit loans under the 2007 Credit Agreement. A portion of the letters of credit outstanding under the 2007 Credit Agreement at the time of its termination were continued under the March 2011 Credit Agreement and the remainder were continued under the December 2011 Credit Agreements.

The December 2011 Secured Credit Agreement provides for the issuance of letters of credit in an aggregate amount of up to $650 million. The December 2011 Unsecured Credit Agreement is a $1.35 billion facility that provides for the issuance of letters of credit and revolving credit loans in an aggregate amount up to $1 billion. We have the option to increase the maximum amount of letters of credit available by an additional $500 million across the facilities under the December 2011 Credit Agreements.

The commitments under each December 2011 Credit Agreement expire on, and such credit facilities are available until, the earlier of (i) December 9, 2015 and (ii) the date of termination in whole of the commitments upon an optional termination or reduction of the commitments by the account parties or upon an event of default.

The availability of letters of credit under the December 2011 Secured Credit Agreement and the March 2011 Credit Agreements is subject to a borrowing base requirement, determined on the basis of specified percentages of the face value of eligible categories of assets varying by type of collateral. In the event that such credit support is insufficient, we could be required to provide alternative security to cedants. This could take the form of insurance trusts supported by our investment portfolio or funds withheld (amounts retained by ceding companies to collateralize loss or premium reserves) using our cash resources or combinations thereof. The face amount of letters of credit required is driven by, among other things, loss development of existing reserves, the payment pattern of such reserves, the expansion of our business written by us and the loss experience of such business. In addition to letters of credit, we have established insurance trusts in the United States that provide cedants with statutory credit for reinsurance under state insurance regulation in the United States. For a discussion of collateral requirements for our Life operations, see Item 1, Business Segments Life Operations Segment Life Operations Collateral Requirements.

We review current and projected collateral requirements on a regular basis, as well as new sources of collateral. Our objective is to maintain an excess amount of collateral sources over expected uses. We also review our liquidity needs on a regular basis.

In October 2011, the $75,000 letter of credit facility that was supporting one of our subsidiaries was terminated.

Covenants

Our Credit Facilities contain a number of financial covenants that must be met and maintained and that, among other things, could restrict, subject to certain exceptions, our financial flexibility including the ability to:

- engage in mergers or consolidations;
- dispose of assets outside of the ordinary course of business;
- create liens on assets; and
- engage in certain transactions with affiliates.

The following outlines the covenant requirements and actual amounts as of December 31, 2012:

	Covenant Requirement	Actual Ratio or Balance	Margin of Compliance at December 31, 2012
Ratio of Total Funded Debt to Total Capitalization (1)	Less than 0.35:100	0.14 : 1.00	$2.6 billion
Maximum Secured Indebtedness (2)	Less than 15% of consolidated net worth	Nil	$1.6 billion
Consolidated Net Worth (3)	$6.8 billion	$10.4 billion	$3.6 billion
Financial Strength Ratings (4)	A or better from A.M. Best	A (Stable)	Two notches

(1) The ratio of total funded debt to total capitalization not to be greater than 0.35:1.00. This ratio is defined as

total funded debt to the sum of total funded debt plus consolidated net worth.

(2) Secured indebtedness excludes secured letter of credit facilities as permitted under the schedules to the credit facilities. At December 31, 2012, such secured letter of credit facilities amounted to $1.64 billion.

(3) Consolidated net worth means, at any time, our consolidated stockholders equity excluding (a) the effect of any adjustments required under the authoritative accounting guidance for accounting for certain investments in debt and equity securities; and (b) any exempt

indebtedness (and the assets relating thereto) in the event such exempt indebtedness is consolidated on our consolidated balance sheet.

(4) Covenants require that none of XL Insurance (Bermuda) Ltd, XL Re Ltd or XL Re Europe Ltd has a financial strength ratings of less than A from A.M. Best. At December 31, 2012, we were in compliance with such covenants.

As noted in the table above, at December 31, 2012, we were in compliance with all covenants by significant margins, and we currently remain in compliance.

Cross-Default And Other Provisions In Debt Instruments

The following describes certain terms of the documents referred to below. All documents referred to below have been filed with the SEC and should be referred to for an assessment of our complete contractual obligations.

In general, all of our bank facilities, indentures and other documents relating to our outstanding indebtedness, including the credit facilities discussed above (collectively, the Debt Documents), contain cross acceleration or cross default provisions to each other and the Debt Documents contain affirmative covenants. These covenants provide for, among other things, minimum required ratings of our insurance and reinsurance operating subsidiaries and minimum required levels of secured indebtedness in the future. In addition, generally each of the Debt Documents provide for an event of default in the event of a change of control of the Company or certain events involving bankruptcy, insolvency or reorganization of the Company.

A downgrade below A of our principal insurance and reinsurance subsidiaries by either S&P or A.M. Best, which is two notches below the current S&P financial strength rating of A (Positive) and the A.M. Best financial strength

rating of A (Stable) of these subsidiaries, may trigger cancelation provisions in a significant amount of our assumed reinsurance agreements and may potentially require us to return unearned premiums to cedants. In addition, due to collateral posting requirements under our letter of credit and revolving credit facilities, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities (see Liquidity and Capital Resources). In certain limited

instances, such downgrades may require us to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1A, Risk Factors A downgrade or potential downgrade in our financial strength and credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations and/or liquidity.

Under the March 2011 Credit Agreement and December 2011 Credit Agreements, in the event that XL Insurance (Bermuda) Ltd, XL Re Ltd or XL Re Europe Ltd fail to maintain a financial strength rating of at least A from A.M. Best, an event of default would occur.

Given that all of the Debt Documents contain cross acceleration or cross default provisions, this may result in all holders declaring such debt due and payable and an acceleration of all debt due under those documents. If this were to occur, we may not have funds sufficient at that time to repay any or all of such indebtedness.

Long-Term Contractual Obligations

The following table presents our long term contractual obligations and related payments at December 31, 2012, due by period. This table excludes further commitments of $142.1 million related to our investment funds and certain limited partnerships, and in use letter of credit facilities of $1.8 billion. See Item 8, Note 14, Derivative Instruments, Note 17, Commitments and Contingencies, and Note 13, Notes Payable and Debt and Financing Arrangements, to the Consolidated Financial Statements included herein, for further information.

Contractual Obligations *(U.S. dollars in thousands)*	**Total**	**Less than 1 year**	**1 to 3 years**	**3 to 5 years**	**More than 5 years**
Long-term debt obligations	$ 1,675,000	$	$ 600,000	$	$ 1,075,000
Interest on long-term debt	844,617	98,625	164,828	132,405	448,759
Operating lease obligations	264,689	38,096	66,867	51,072	108,654
Capital lease obligations	222,415	11,927	24,757	26,011	159,720
Deposit liabilities (1)	2,285,364	158,215	351,831	205,265	1,570,053
Future policy benefits (2)	7,467,945	397,080	779,978	769,565	5,521,322
Unpaid losses and loss expenses P&C (3)	20,878,662	4,388,998	6,326,114	3,667,048	6,496,502
Total	$ 33,638,692	$ 5,092,941	$ 8,314,375	$ 4,851,366	$ 15,380,010

(1) Deposit liabilities on our Consolidated Balance Sheet at December 31, 2012 were $1.5 billion. The difference from the amount included above relates to the discount on payments due in the future. The payment related to these liabilities varies primarily based on interest rates. The ultimate payments associated with these liabilities could differ from our estimate. See Item 8, Note 11, Deposit Liabilities, to the Consolidated Financial Statements included herein, for further information.

(2) Future policy benefit

reserves related to Life operations were $4.8 billion on our Consolidated Balance Sheet at December 31, 2012. Amounts reflected above include an allowance for future premiums in respect of contracts under which premiums are payable throughout the life of the underlying policy. The value of the discount is also included for those lines of business that have reserves where future claim payments and future premium receipts can be estimated using actuarial principles. The timing and amounts of actual claims payments and premium receipts related to these reserves vary based on the underlying

experience of the portfolio. Typical elements of the experience include mortality, morbidity and persistency. The ultimate amount of the claims payments and premium receipts could differ materially from our estimated amounts.

(3) The unpaid loss and loss expenses were $20.5 billion on our Consolidated Balance Sheet at December 31, 2012. The difference from the amount included above relates to the discount on payments due in the future for certain workers compensation lines and certain U.K. motor liability claims. The timing and amounts of actual claims payments related to

these P&C reserves vary based on many factors including large individual losses, changes in the legal environment, as well as general market conditions. The ultimate amount of the claims payments could differ materially from our estimated amounts. For information regarding the estimates for unpaid loss and loss expenses as well as factors affecting potential payment patterns of reserves for actual and potential claims related our different lines of business, see Critical Accounting Policies and Estimates above. Certain lines of business written by us, such as excess

casualty, have loss experience characterized as low frequency and high severity. This may result in significant variability in loss payment patterns and, therefore, may impact the related asset/liability investment management process. In order to be in a position, if necessary, to make these payments, our liquidity requirements are supported by having revolving lines of credit facilities available to us and significant reinsurance programs, in addition to our general high grade fixed income investment portfolio.

Variable Interest Entities (VIEs) and Other Off-Balance Sheet Arrangements

At times, we have utilized VIEs both indirectly and directly in the ordinary course of our business.

We invest in CDOs and other investment vehicles that are issued through variable interest entities as part of our investment portfolio. The activities of these VIEs are generally limited to holding the underlying collateral used to service investments therein. Our involvement in these entities is passive in nature and we are not the arranger of these entities. We have not been involved in establishing these entities. We are not the primary beneficiary of these variable interest entities as contemplated in current authoritative accounting guidance.

We have a limited number of remaining outstanding credit enhancement exposures, including written financial guarantee and credit default swap contracts. The obligations related to these transactions are often securitized through variable interest entities. We are not the primary beneficiary of these variable interest entities as contemplated in current authoritative accounting guidance. For further details on the nature of the obligations and the size of our maximum exposure see Item 8, Note 14, Derivative Instruments, and Note 17(h), Commitments and Contingencies Financial and Other Guarantee Exposures, to the Consolidated Financial Statements included herein.

We have utilized variable interest entities in certain instances as a means of accessing contingent capital. We have utilized unconsolidated entities in the formation of contingent capital facilities.

At December 31, 2012, we did not have any contingent capital facilities. Previously we had a contingent capital facility as a result of an agreement with Stoneheath that was terminated in the fourth quarter of 2011.

We entered into this facility on December 5, 2006. We and ceding insurers entered into a securities issuance agreement, and certain of our ceding insurers entered into a reinsurance agreement, with Stoneheath. The net effect of these agreements to us was the creation of a contingent put option in the amount of $350.0 million in the aggregate. Our interests in Stoneheath represented an interest in a variable interest entity under current authoritative accounting guidance, however, we were not the primary beneficiary as contemplated in that guidance. For further details see Item 8, Note 15, Off-Balance Sheet Arrangements, to the Consolidated Financial Statements included herein.

The agreements provided us with a reinsurance collateral account in support of certain covered perils named in the reinsurance agreement. The covered perils include U.S. wind, European wind, California earthquake and terrorism worldwide. The contingent put option was recorded at fair value with changes in fair value recognized in earnings.

Recent Accounting Pronouncements

See Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included herein, for a discussion of recent accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

The following risk management discussion and the estimated amounts generated from the sensitivity and value-at-risk (VaR) analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of our investment portfolio. The results of analysis used by us to assess and mitigate risk should not be considered projections of future events of losses. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Market risk represents the potential for loss due to adverse changes in the fair value of financial and other instruments. We are principally exposed to the following market risks: interest rate risk, foreign currency exchange rate risk, credit risk, equity price risk and other related market risks.

The majority of our market risk arises from the investment portfolio, which consists of fixed income securities, alternative investments, public equities, private investments, derivatives, other investments and cash, denominated in both U.S. and foreign currencies, which are sensitive to changes in interest rates,

credit spreads, equity prices, foreign currency exchange rates and other related market risks. Our fixed income and equity securities are generally classified as available for sale, and, as such, changes in interest rates, credit spreads on corporate and structured securities, equity prices, foreign currency exchange rates or other related market instruments will have an immediate effect on comprehensive income and shareholders equity but will not ordinarily have an immediate effect on net income. Nevertheless, changes in interest rates, credit spreads and defaults, equity prices and other related market instruments affect consolidated net income when, and if, a security is sold or impaired.

We may enter into derivatives and other financial instruments primarily for risk management purposes. For example, we may use derivatives to hedge foreign exchange and interest rate risk related to our consolidated net exposures. From time to time, we may also use instruments such as futures, options, interest rate swaps, credit default swaps and foreign currency forward contracts to manage the risk of interest rate changes, credit deterioration, foreign currency exposures, and other market related exposures as well as to obtain exposure to a particular financial market. Historically, we entered into credit derivatives outside of the investment portfolio in conjunction with the legacy financial guarantee and financial products operations. We attempt to manage the risks associated with derivative use with guidelines established by senior management. Derivative instruments are carried at fair value with the resulting changes in fair value recognized in income in the period in which they occur. For further information, see Item 1, Note 14, Derivative Instruments, to the Consolidated Financial Statements included herein.

This risk management discussion and the estimated amounts generated from the sensitivity and VaR analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of our investment portfolio. The results of analysis used by us to assess and mitigate risk should not be considered projections of future events of losses. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Interest Rate Risk

Interest rate risk is the price sensitivity of a fixed income security to changes in interest rates. Our fixed income portfolio is exposed to interest rate risk. Our liabilities are accrued at a static rate from an accounting standpoint. However, management considers the liabilities to have an economic exposure to interest rate risk and manages the net economic exposure to interest rate risk considering both assets and liabilities. Interest rate risk is managed within the context of our SAA process by specifying SAA benchmarks relative to the estimated duration of our liabilities and managing the fixed income portfolio relative to the benchmarks such that the overall economic effect of interest rate risk is within management s risk tolerance. Nevertheless, we remain exposed to interest rate risk with respect to our overall net asset position and more generally from an accounting standpoint since the assets are carried at fair value, while liabilities are accrued at a static rate.

In addition, while our debt is not carried at fair value and not adjusted for market changes, changes in market interest rates could have an impact on debt values at the time of any refinancing.

Foreign Currency Exchange Rate Risk

Many of our non-U.S. subsidiaries maintain both assets and liabilities in local currencies; therefore, foreign exchange risk is generally limited to net assets denominated in foreign currencies.

Foreign currency exchange rate gains and losses in our Statement of Income arise for accounting purposes when net assets or liabilities are denominated in foreign currencies that differ from the functional currency of those subsidiaries. While unrealized foreign exchange gains and losses on underwriting balances are reported in earnings, the offsetting unrealized gains and losses on invested assets are recorded as a separate component of shareholders equity, to the extent that the asset currency does not match that entity s functional currency. This results in an accounting mismatch

that will result in foreign exchange gains or losses in the consolidated statements of income depending on the movement in certain currencies. We have formed several branches with Euro and U.K. sterling functional currencies and continue to focus on attempting to limit exposure to foreign exchange risk.

Foreign currency exchange rate risk in general is reviewed as part of our risk management framework. Within the asset liability framework for the investment portfolio, we pursue a general policy of holding the assets and liabilities in the same currency and, as such, we are not generally exposed to the risks associated with foreign exchange movements within the investment portfolio, as currency impacts on the assets are generally matched by corresponding impacts on the related liabilities. However, locally-required capital levels are invested in local currencies in order to satisfy regulatory requirements and to support local insurance operations and are not matched by related liabilities. Foreign exchange contracts within the investment portfolio may be utilized to manage individual portfolio foreign exchange exposures, subject to investment management service providers guidelines established by management. Where these contracts are not designated as specific hedges for financial reporting purposes, we record realized and unrealized gains and losses in income in the period in which they occur. These contracts generally have maturities of three months or less. We may also attempt to manage the foreign exchange volatility arising on certain transactions denominated in foreign currencies. These include, but are not limited to, premium receivable, reinsurance contracts, claims payable and investments in subsidiaries.

The principal currencies creating our foreign exchange risk are the U.K. sterling, the Euro, the Swiss franc and the Canadian dollar. The following table provides more information on our net exposures to these principal foreign currencies at December 31, 2012 and December 31, 2011:

(Foreign Currency in Millions)	**2012**	**2011**
Euro	252.2	52.0
U.K. Sterling	81.6	35.1
Swiss Franc	117.0	153.7
Canadian Dollar	129.2	222.5

Credit Risk

Credit risk relates to the uncertainty of an obligor s continued ability to make timely payments in accordance with the contractual terms of the instrument or contract. We are exposed to direct credit risk within our investment portfolio, through general counterparties, including customers and reinsurers, and through certain underwriting activities which include, but are not limited to, surety, workers compensation, environmental and political risk and trade credit.

We have an established credit risk governance process delegated to the Credit Subcommittee of the Enterprise Risk Management Committee. The governance process is designed to ensure that transactions and activities, individually and in the aggregate, are carried out within established risk tolerances. This process also recognizes the potential for clash risk that could arise from credit events owing to the identified credit risk embedded in certain underwriting businesses, as well as our investment activities and reinsurance relationships. In particular, certain of our underwriting activities expose us to indirect credit risk in that profitability of certain strategies can correlate with credit events at the issuer, industry or country level. We manage these risks through established underwriting policies that operate in accordance with established limit and escalation frameworks.

To manage our exposure to credit risk, we have established a credit risk framework which establishes tolerances for credit risk at various levels of granularity (counterparty, industry, country and underwriting business) and tolerances for credit risk arising from certain clash events. Credit risk capacity is allocated across our businesses and functional areas and regular reporting and aggregation activities are carried out to ensure compliance with our credit risk framework and related tolerances. Credit risk arising from credit sensitive underwriting activities is also managed via our underwriting limit framework (see Item 1, Enterprise Risk Management). We manage credit risk within the investment portfolio through our SAA framework and established investment credit policies, which address quality of obligors and counterparties, industry limits, and diversification requirements. Our exposure to market credit spreads primarily relates to market price and cash flow variability associated with changes in credit spreads.

Credit Risk Investment Portfolio

Credit risk in the investment portfolio is the exposure to adverse changes in the creditworthiness of individual investment holdings, issuers, groups of issuers, industries and countries. A widening of credit

spreads will increase the net unrealized loss position, will increase losses associated with credit-based derivatives where we assume credit exposure, and, if issuer credit spreads increase significantly for an extended period of time and, in a period of increasing defaults, would also likely result in higher OTTI charges. All else held equal, credit spread tightening will reduce net investment income associated with new purchases of fixed maturities. In addition, market volatility can make it difficult to value certain of our securities if trading becomes less frequent. As such, valuations may include assumptions or estimates that may have significant period to period changes that could have a material adverse effect on our consolidated results of operations or financial condition. The credit spread duration in our fixed income portfolio, excluding the impact of the HTM election, was 3.8 years at December 31, 2012.

We manage credit risk in the investment portfolio, including fixed income, alternative and short-term investments, through the credit research performed primarily by the investment management service providers. The management of credit risk in the investment portfolio is integrated in our credit risk management governance framework and the management of credit exposures and concentrations within the investment portfolio is carried out in accordance with our risk policies, philosophies, appetites, limits and risk concentrations delegated to the investment portfolio. In the investment portfolio, we review on a regular basis our asset concentration, credit quality and adherence to our credit limit guidelines. Any issuer over its credit limits, experiencing financial difficulties, material credit quality deterioration or potentially subject to forthcoming credit quality deterioration is placed on a watch list for closer monitoring. Where appropriate, exposures are reduced or prevented from increasing.

The table below shows our aggregate fixed income portfolio by credit rating in percentage terms of our aggregate fixed income exposure (including fixed maturities, short-term investments, cash equivalents and net payable for investments purchased) at December 31, 2012.

	Percentage of Aggregated Fixed Income Portfolio (1)(2)
AAA	47.0 %
AA	17.8 %
A	22.3 %
BBB	10.0 %
BB or Below	2.8 %
NR	0.1 %
Total	100.0 %

(1) Included in the above are $194.3 million or 0.6% of the fixed income portfolio that

represents medium term notes rated at the average credit rating of the underlying asset pools backing the notes.

(2) The credit ratings above were principally determined based on the weighted average rating of the individual securities from Standard & Poor s, Moody s Investors Service and Fitch Ratings (where available). U.S. Agency debt and related mortgage backed securities, whether with implicit or explicit government support, reflect the credit quality rating of the U.S. government for the purpose of these calculations.

At December 31, 2012, the average credit quality of our aggregate fixed income investment portfolio was Aa2/AA . Our $9.5 billion portfolio of government and government related, agency, sovereign and cash holdings was rated AA+ at December 31, 2012. Our $11.9 billion portfolio of corporates was rated A. Our $9.5 billion structured securities portfolio was AA+ rated.

We are closely monitoring our corporate financial bond holdings given the events of the past five years. The table below summarizes our significant exposures (defined as bonds issued by financial institutions with an amortized cost in excess of $50.0 million) to corporate bonds of financial issuers

including Covered Bonds held within our AFS and HTM investment portfolio holdings at December 31, 2012, representing both amortized cost and net unrealized gains (losses):

(U.S. dollars in millions)

	December 31, 2012		
Issuer (by Global Ultimate Parent) (1)	**Weighted Average Credit Quality (2)**	**Amortized Cost**	**Unrealized Gain/(Loss)**
JPMorgan Chase & Co.	AA	$ 173.3	$ 2.8
Lloyd s Banking Group plc	AA	169.3	8.0
Citigroup Inc.	AA	167.1	6.8
Rabobank Nederland NV	BBB+	151.0	7.8
National Australia Bank Limited	A	141.1	7.0
The Goldman Sachs Group, Inc.	BBB+	130.4	11.7
HSBC Holdings plc	A+	121.7	
UBS AG	A	118.9	3.5
Morgan Stanley	BBB+	117.7	3.1
Bank of America Corporation	AA	113.2	4.9
The Bank of Nova Scotia	A+	103.4	3.6
Wells Fargo & Company	AA	97.7	5.2
Westpac Banking Corporation	A	92.0	6.5
ING Groep N.V.	A+	86.1	3.1
Credit Suisse Group AG	AA	85.7	2.4
Commonwealth Bank of Australia	AA+	82.6	5.4
Standard Chartered plc	AA	77.3	4.3
Nordea Bank AB	A	77.0	2.6
Canadian Imperial Bank of Commerce	AA	74.0	3.0
BNP Paribas	AA	70.6	2.9
Royal Bank of Canada	AA	70.2	1.9
Bank of Montreal	A+	69.5	2.6
The Bank of New York Mellon Corporation	A+	58.3	2.7
Australia and New Zealand Banking Group Limited	A+	57.7	2.7
Government of Netherlands (ABN AMRO)	AAA+	54.5	7.1
Northern Rock PLC	BBB	50.9	6.3
Legal & General Group PLC	BBB+	50.6	0.3

(1) Includes Covered Bonds.

(2) The credit rating for each asset reflected above was principally determined based on the weighted average rating of the individual securities from Standard & Poor s, Moody s Investors Service and Fitch Ratings. U.S. Agency debt and related mortgage backed securities, whether with implicit or explicit government support, reflects the credit quality rating of the U.S. government for the purpose of these calculations.

Within our corporate financial bond holdings, we are further monitoring exposures to hybrid securities, representing Tier One and Upper Tier Two securities of various financial institutions. The following table summarizes our top ten exposures to hybrid securities:

(U.S. dollars in millions)

Issuer (by Global Ultimate Parent)	**December 31, 2012**			
	Tier One Amortized Cost	**Upper Tier Two Amortized**	**Total Amortized Cost**	**Net Unrealized Gain (Loss)**

				Cost				
Barclays, Plc	$	4.8	$	36.1	$	40.9	$	(5.4)
Zurich Financial Services AG				26.7		26.7		0.9
Nationwide Building Society		21.6				21.6		(2.7)
The British United Provident Association Limited				20.9		20.9		(1.4)
National Australia Bank Limited		20.8				20.8		(0.4)
JPMorgan Chas & Co.		20.5				20.5		(4.4)
Aviva PLC		5.5		13.9		19.4		(1.9)
Mitsubishi UFJ Financial Group, Inc.		19.1				19.1		1.4
Legal & General Group PLC				18.9		18.9		0.3
The Goldman Sachs Group, Inc.		18.6				18.6		0.7
Total	$	110.9	$	116.5	$	227.4	$	(12.9)

At December 31, 2012, the top 10 corporate financial holdings, which exclude government guaranteed and government sponsored enterprises, represented approximately 4.5% of the aggregate fixed income portfolio and approximately 12.4% of all corporate holdings. The top 10 corporate bond holdings listed below represent the direct exposure to the corporations listed below, including their subsidiaries, and

excludes any securitized, credit enhanced and collateralized asset or mortgage-backed securities, cash and cash equivalents, pooled notes and any over-the-counter (OTC) derivative counterparty exposures, if applicable, but does include Covered Bonds.

Top 10 Corporate Financial Holdings (1)	Percentage of Aggregate Fixed Income Portfolio
Lloyd s Banking Group PLC	0.5 %
JPMorgan Chase & Co.	0.5 %
Citigroup Inc.	0.5 %
Rabobank Nederland NV	0.5 %
National Australia Bank Limited	0.5 %
The Goldman Sachs Group, Inc	0.4 %
UBS AG	0.4 %
HSBC Holdings PLC	0.4 %
Morgan Stanley	0.4 %
Bank of America Corporation	0.4 %

(1) Corporate issuers include Covered Bonds.

At December 31, 2012, the top 5 corporate sector exposures listed below represented 28.5% of the aggregate fixed income investment portfolio and 79.4% of all corporate holdings.

(U.S. dollars in millions)

Top 5 Sector Exposures	Carrying Value	Percentage of Aggregate Fixed Income Portfolio
Financials (1)	$ 3,507.4	10.5 %
Consumer, Non-Cyclical	2,317.7	7.0 %
Utilities	1,500.6	4.5 %
Industrial	1,082.7	3.3 %
Communications	1,067.7	3.2 %
Total	$ 9,476.1	28.5 %

(1) Government-guaranteed securities and Covered Bonds have been excluded from the above figures.

Within our fixed income portfolios, we are further monitoring our exposure to holdings representing risk in certain Euro-zone countries (Greece, Italy, Ireland, Portugal and Spain, collectively GIIPS). In particular, the fair values of our holdings representing risk in GIIPS are: government holdings of $15.4 million, corporate holdings of $118.3 million (financials $0.4 million, non-financials $117.9 million) and structured securities holdings totaling $9.6 million. The non-financial corporate holdings primarily consist of securities issued by multinational companies with low reliance on local economics and systemically important industries such as utilities and telecoms. For further detail on our exposure to the Euro-zone sovereign debt crisis, please refer to Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations European Sovereign Debt Crisis.

We also have exposure to credit risk associated with our mortgage-backed and asset-backed securities. The table below shows the breakdown of the $9.5 billion structured securities portfolio, of which 79.9% is AAA rated:

(U.S. dollars in millions)	**Carrying Value**	**Percentage of Structured Portfolio**
Agency RMBS	$ 5,255.5	55.4 %
Other ABS (1)	1,693.1	17.9 %
CMBS	1,090.0	11.5 %
Non-Agency RMBS	730.9	7.7 %
Core CDO (non-ABS CDOs and CLOs)	709.8	7.5 %
Total	$ 9,479.3	100.0 %

(1) Includes Covered Bonds.

Credit Risk Other

Credit derivatives are purchased within our investment portfolio and were sold through a limited number of contracts written as part of our previous financial lines business. From time to time, we may purchase credit default swaps to hedge an existing position or concentration of holdings. The credit derivatives are recorded at fair value. For further details with respect to our exposure to credit derivatives, see Item 1, Note 14, Derivative Instruments, to the Consolidated Financial Statements included herein.

We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, alternatives and other investment funds and other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty. In addition, with respect to secured transactions, our credit risk may be exacerbated when the collateral held by us cannot be sold or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due. We also have exposure to financial institutions in the form of unsecured debt instruments, derivative transactions, revolving credit facility and letter of credit commitments and equity investments. There can be no assurance that any such losses or impairments to the carrying value of these assets would not materially and adversely affect our business and results of operations.

With regard to unpaid losses and loss expenses recoverable and reinsurance balances receivable, we have credit risk should any of our reinsurers be unable or unwilling to settle amounts due to us; however, these exposures are not marked to market. For further information relating to reinsurer credit risk, see Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable.

We are exposed to credit risk in the event of non-performance by the other parties to our derivative instruments in general; however, we do not anticipate non-performance. The difference between the notional principal amounts and the associated market value is our maximum credit exposure.

Equity Price Risk

Equity price risk is the potential loss arising from changes in the market value of equities. Our equity investment portfolio is exposed to equity price risk. At December 31, 2012, our equity portfolio was approximately $547.1 million as compared to $376.6 million at December 31, 2011. This excludes fixed income fund investments of $101.9 million and $91.6 million at December 31, 2012 and 2011, respectively, that generally do not have the risk characteristics of equity investments but are treated as equity investments under U.S. GAAP. At December 31, 2012 and 2011, our direct allocation to equity securities was 1.5% and 1.1%, respectively, of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased.) We also estimate the equity risk embedded in certain alternative and private investments. Such estimates are derived from market exposures provided to us by certain individual fund investments and/or internal statistical analyses.

Other Market Risks

Our private investment portfolio is invested in limited partnerships and other entities that are not publicly traded. In addition to normal market risks, these positions may also be exposed to liquidity risk, risks related to distressed investments and risks specific to startup or small companies. At December 31, 2012, our exposure to private investments, excluding unfunded commitments, was $307.5 million, representing 0.8% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) compared to $288.4 million at December 31, 2011.

Our alternative investment portfolio, which is exposed to equity and credit risk as well as certain other market risks, had a total exposure of $1,322.1 million representing approximately 3.9% of the investment portfolio (including cash

and cash equivalents, accrued investment income and net payable for investments purchased) at December 31, 2012, as compared to December 31, 2011, when we had a total exposure of $1,027.2 million representing approximately 3.1% of the fixed income investment portfolio.

At December 31, 2012, bond and stock index futures outstanding had a net long position of $46.5 million as compared to a net long position of $12.6 million at December 31, 2011. We may reduce our exposure to these futures through offsetting transactions, including options and forwards.

As noted above, we also invest in certain derivative positions that can be impacted by market value movements. For further details on derivative instruments, see Item 1, Note 14, Derivative Instruments, to the Consolidated Financial Statements included herein.

Sensitivity and Value-at-Risk Analysis

Value-at-Risk (VaR) is central to our market risk management framework for the investment portfolio. VaR is a statistical risk measure representing a specific percentile of estimated potential mark-to-market portfolio returns in normal market conditions over a specific time horizon.

We estimate the VaR of the investment portfolio, the P&C investment portfolio and the Life operations investment portfolio, using a one year holding period and a 95% level of confidence. This means that, on average, we could expect mark-to-market losses greater than predicted by the VaR results 5% of the time, or once every 20 years.

The calculation of VaR is performed monthly using an analytical, or variance-covariance approach, based on the linear sensitivity of the investment portfolio and individual securities to a broad set of systematic market risk factors and idiosyncratic risk factors. We estimate the parametric sensitivity of every security in the investment portfolio to changes in key interest rates, spreads, implied volatility and equities. The parametric exposures are summed using the appropriate investment portfolio weights to compute the investment portfolio s exposure to these systematic and idiosyncratic market risk factors.

The modeling of risk, as measured by VaR, involves a number of assumptions and approximations. While we believe that our assumptions and approximations are appropriate, there is no uniform industry methodology for calculating VaR. We note that different VaR results can be produced for the same portfolio dependent not only on the approach used but also on the assumptions employed when implementing the approach.

The VaR approach uses historical data to determine the sensitivity of each of the underlying securities to the risk factors incorporated into the pricing models employed in the VaR estimates. In calculating these sensitivities, greater importance is placed on the more recent data points and information. Since the VaR approach is based on historical positions and market data, VaR results should not be viewed as an absolute and predictive gauge of future financial performance or as a way for us to predict risk. There is no assurance that our actual future losses will not exceed our VaR and we expect that 5% of the time the VaR will be exceeded.

Additionally, we acknowledge the fact that risks associated with abnormal market events can be significantly different from the VaR results and these are by definition not reflected or assessed in the VaR analysis, rather VaR is evaluated using our stress testing framework.

The table below summarizes our assessment of the estimated impact on the value of our investment portfolio at December 31, 2012 associated with an immediate and hypothetical: +100bps increase in interest rates, a -10% decline in equity markets, a +100bps widening in spreads and a +10% widening in spreads. The table also reports the 95%, 1-year VaRs for our investment portfolios at December 31, 2012, excluding foreign exchange.

The interest rate, spread risk, and VaR referenced in the table below include the impact of market movements on our held to maturity fixed maturities from our Life operations investment portfolio. While the market value of these holdings is sensitive to prevailing interest rates and credit spreads, our book value is not impacted as these holdings are carried at amortized cost. At December 31, 2012, if we were to exclude these impacts in order to present the impact of these risks to our book value, the interest rate risk would be reduced by approximately $331.8 million, absolute spread risk would be reduced by approximately $225.6 million, relative spread risk would be reduced by approximately $24.4 million, and VaR would be reduced by approximately $288.0 million.

The table below excludes the impact of foreign exchange rate risk on our investment portfolio. Our investment strategy incorporates asset-liability management, and, accordingly, any foreign exchange movements impact the assets and liabilities approximately equally. See Foreign Currency Exchange Rate Risk, for further details. We consider that the investment portfolio VaR estimated results as well as the P&C and Life operations investment portfolios VaR estimated results excluding foreign exchange rate risk

are the more relevant and appropriate metrics to consider when assessing the actual risk of the investment portfolio.

The estimated results below also do not include any risk contributions from our various operating affiliates (strategic, investment manager or financial operating affiliates) or certain other investments that are carried at amortized cost.

(U.S. dollars in millions)		**Interest Rate Risk (1)**		**Equity Risk (2)**		**Absolute Spread Risk (3)**		**Relative Spread Risk (4)**		**VaR (5), (6)**
Total Investment Portfolio (7)	**$**	**(1,446.2)**	**$**	**(121.6)**	**$**	**(1,385.0)**	**$**	**(162.7)**	**$**	**852.0**
A. P&C Investment Portfolio	**$**	**(847.7)**	**$**	**(121.6)**	**$**	**(871.3)**	**$**	**(80.3)**	**$**	**425.5**
(I) P&C Fixed Income Portfolio		(847.7)				(871.3)		(80.3)		446.8
(a) Cash & Short Term Investments		(9.7)				(8.2)		(0.2)		2.2
(b) Total Government Related		(320.2)				(222.1)		(9.5)		162.6
(c) Total Corporate Credit		(289.5)				(320.0)		(34.2)		174.8
(d) Total Structured Securities		(228.3)				(321.1)		(36.3)		167.0
(II) P&C Non-Fixed Income Portfolio				(121.6)						137.2
(e) Equity Portfolio				(55.6)						71.0
(f) Alternative Portfolio				(31.7)						62.6
(g) Private Investments				(34.3)						51.9
(h) Other										2.2
B. Life Operations Investment Portfolio	**$**	**(591.2)**	**$**		**$**	**(477.5)**	**$**	**(78.4)**	**$**	**490.9**
(III) Life Fixed Income Portfolio		(591.2)				(477.5)		(78.4)		490.9
(i) Cash & Short Term Investments		(0.1)								0.1
(j) Total Government Related		(241.3)				(91.7)		(5.0)		202.9
(k) Total Corporate Credit		(286.6)				(312.7)		(57.9)		243.9

(l) Total Structured Securities	(63.3)	(73.1)	(15.6)	54.0
(IV) Life Non-Fixed Income Portfolio				

(1) The estimated impact on the fair value of our fixed income portfolio of an immediate hypothetical +100 bps adverse parallel shift in global bond curves.

(2) The estimated impact on the fair value of our investment portfolio of an immediate hypothetical -10% change in the value of equity exposures in our equity portfolio, certain equity-sensitive alternative investments and private equity investments. This includes our estimate of equity risk embedded in the alternatives and private investment portfolio with such estimates utilizing market exposures

provided to us by certain individual fund investments, internal statistical analyses, and/or various assumptions regarding illiquidity and concentrations.

(3) The estimated impact on the fair value of our fixed income portfolio of an immediate hypothetical +100 basis point increase in all global government related, corporate and structured security spreads to which our fixed income portfolio is exposed. This excludes exposure to credit spreads in our alternative investments, private investments and counterparty exposure.

(4) The estimated impact on the fair value of our fixed income portfolio of an immediate hypothetical +10% increase in all global

government related, corporate and structured security spreads to which our fixed income portfolio is exposed. This excludes exposure to credit spreads in our alternative investments, private investments and counterparty exposure.

(5) The VaR results are based on a 95% confidence interval, with a one-year holding period, excluding foreign exchange rate risk. Our investment portfolio VaR at December 31, 2012 is not necessarily indicative of future VaR levels as these are based on statistical estimates of possible price changes and, therefore, exclude other sources of investment return such as coupon and dividend income.

(6) The VaR results are the standalone VaRs, based on the prescribed methodology, for each component of our Total Investment Portfolio. The standalone VaRs of the individual components are non-additive, with the difference between the summation of the individual component VaRs and their respective aggregations being due to diversification benefits across the individual components. In the case of the VaR results for our Total Investment Portfolio, the results also include the impact associated with our Business and Other Investments.

(7) Our Total Investment Portfolio comprises our P&C Investment Portfolio and Life Operations

Investment Portfolio as well as our Business and other investments that do not form part of our P&C Investment Portfolio or Life Operations Investment Portfolio. The individual results reported in the above table for our Total Investment Portfolio therefore represent the aggregate impact on our P&C Investment Portfolio, Life Operations Investment Portfolio and the majority of our other investments.

Stress Testing

VaR does not provide the means to estimate the magnitude of the loss in the 5% of occurrences when we expect the VaR level to be exceeded. To complement the VaR analysis based on normal market environments, we consider the impact on the investment portfolio in several different stress scenarios to analyze the effect of unusual market conditions. We establish certain stress scenarios that are applied to the

actual investment portfolio. As these stress scenarios and estimated gains and losses are based on scenarios established by us, they will not necessarily reflect future stress events or gains and losses from such events. The results of the stress scenarios are reviewed on a regular basis to ensure they are appropriate, based on current shareholders equity, market conditions and our total risk tolerance. It is important to note that when assessing the risk of our investment portfolio, we do not take into account either the value or risk associated with the liabilities arising from our operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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XL GROUP PLC
CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31, 2012 and 2011

(U.S. dollars in thousands, except share data)	2012	2011
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost: 2012: $26,544,806; 2011: $25,771,715)	$ 27,846,920	$ 26,190,025
Equity securities, at fair value (cost: 2012: $617,486; 2011: $480,685)	649,359	468,197
Short-term investments, at fair value (amortized cost: 2012: $322,563; 2011: $359,378)	322,703	359,063
Total investments available for sale	$ 28,818,982	$ 27,017,285
Fixed maturities, held to maturity at amortized cost (fair value: 2012: $3,262,804; 2011: $2,895,688)	2,814,447	2,668,978
Investments in affiliates	1,126,875	1,052,729
Other investments	1,219,879	985,262
Total investments	$ 33,980,183	$ 31,724,254
Cash and cash equivalents	2,618,378	3,825,125
Accrued investment income	342,778	331,758
Deferred acquisition costs	675,705	647,113
Ceded unearned premiums	587,909	596,895
Premiums receivable	2,568,861	2,411,611
Reinsurance balances receivable	58,428	220,017
Unpaid losses and loss expenses recoverable	3,382,101	3,654,948
Receivable from investments sold	16,002	59,727
Goodwill and other intangible assets	408,527	407,321
Deferred tax asset	166,142	115,601
Other assets	582,765	670,895
Total assets	$ 45,387,779	$ 44,665,265
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 20,484,121	$ 20,613,901
Deposit liabilities	1,551,398	1,608,108
Future policy benefit reserves	4,812,045	4,845,394
Unearned premiums	3,755,920	3,555,310
Notes payable and debt	1,672,778	2,275,327
Reinsurance balances payable	143,112	90,552

Payable for investments purchased		102,112		58,494
Deferred tax liability		141,803		91,104
Other liabilities		868,093		770,945
Total liabilities	$	33,531,382	$	33,909,135
Commitments and Contingencies				
Shareholders Equity:				
Ordinary shares, 999,990,000 authorized, par value $0.01; issued and outstanding: (2012: 298,681,573; 2011: 315,645,796)	$	2,987	$	3,156
Additional paid in capital		8,584,753		8,938,679
Accumulated other comprehensive income		1,520,011		583,064
Retained earnings (deficit)		402,321		(113,241)
Shareholders equity attributable to XL Group plc	$	10,510,072	$	9,411,658
Non-controlling interest in equity of consolidated subsidiaries		1,346,325		1,344,472
Total shareholders equity	$	11,856,397	$	10,756,130
Total liabilities and shareholders equity	$	45,387,779	$	44,665,265

See accompanying Notes to Consolidated Financial Statements

XL GROUP PLC
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(U.S. dollars in thousands, except per share data)	2012	2011	2010
Revenues:			
Net premiums earned	$ 6,090,441	$ 5,690,130	$ 5,414,061
Net investment income	1,012,348	1,137,769	1,198,038
Realized investment gains (losses):			
Net realized gains (losses) on investments sold	94,810	(28,187)	(65,670)
Other-than-temporary impairments on investments	(54,306)	(174,102)	(170,643)
Other-than-temporary impairments on investments transferred to (from) other comprehensive income	(26,406)	13,930	(34,490)
Total net realized gains (losses) on investments	$ 14,098	$ (188,359)	$ (270,803)
Net realized and unrealized gains (losses) on derivative instruments	5,221	(10,738)	(33,843)
Income (loss) from investment fund affiliates	58,504	26,253	51,102
Fee income and other	49,868	41,748	40,027
Total revenues	$ 7,230,480	$ 6,696,803	$ 6,398,582
Expenses:			
Net losses and loss expenses incurred	$ 3,765,482	$ 4,078,391	$ 3,211,800
Claims and policy benefits	486,198	535,074	513,833
Acquisition costs	913,492	826,411	788,258
Operating expenses	1,173,951	1,083,917	972,963
Exchange (gains) losses	10,546	(40,640)	(10,161)
Interest expense	172,205	205,592	213,643
Impairment of goodwill		429,020	
Loss on termination of guarantee			23,500
Total expenses	$ 6,521,874	$ 7,117,765	$ 5,713,836
Income (loss) before income tax and income (loss) from operating affiliates	$ 708,606	$ (420,962)	$ 684,746
Income (loss) from operating affiliates	55,810	76,786	121,372
Provision (benefit) for income tax	34,028	59,707	162,737

Net income (loss)	$	730,388	$	(403,883)	$	643,381
Non-controlling interests		(79,254)		(70,877)		(39,831)
Net income (loss) attributable to XL Group plc	$	651,134	$	(474,760)	$	603,550
Preference share dividends						(34,694)
Gain on redemption of Redeemable Series C preference ordinary shares						16,616
Net income (loss) attributable to ordinary shareholders	$	651,134	$	(474,760)	$	585,472
Weighted average ordinary shares and ordinary share equivalents outstanding basic		307,372		312,896		336,283
Weighted average ordinary shares and ordinary share equivalents outstanding diluted		310,282		312,896		337,709
Earnings (loss) per ordinary share and ordinary share equivalent basic	$	2.12	$	(1.52)	$	1.74
Earnings (loss) per ordinary share and ordinary share equivalent diluted	$	2.10	$	(1.52)	$	1.73

See accompanying Notes to Consolidated Financial Statements

XL GROUP PLC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(U.S. dollars in thousands)	**2012**	**2011**	**2010**
Net income (loss) attributable to XL Group plc	$ 651,134	$ (474,760)	$ 603,550
Impact of adoption of new authoritative embedded derivative guidance, net of taxes			31,917
Change in net unrealized gains (losses) on investments, net of tax	841,213	446,427	997,066
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	46,163	25,269	44,314
Change in OTTI losses recognized in other comprehensive income, net of tax	67,280	39,456	124,906
Change in underfunded pension liability	(9,985)	(2,622)	(2,619)
Change in net unrealized gain (loss) on future policy benefit reserves			(3,714)
Change in value of cash flow hedge	439	439	439
Foreign currency translation adjustments	(8,163)	(26,700)	50,953
Comprehensive income (loss)	$ 1,588,081	$ 7,509	$ 1,846,812

See accompanying Notes to Consolidated Financial Statements

XL GROUP PLC
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(U.S. dollars in thousands)	**2012**	**2011**	**2010**
Ordinary Shares:			
Balance beginning of year	$ 3,156	$ 3,165	$ 3,421
Issuance of ordinary shares	10	307	
Buybacks of ordinary shares	(183)	(317)	(256)
Exercise of stock options	4	1	
Balance end of year	$ 2,987	$ 3,156	$ 3,165
Series E preference ordinary shares:			
Balance beginning of year	$	$	$ 10
Transfer to non-controlling interest in equity of consolidated subsidiaries			(10)
Balance end of year	$	$	$
Additional Paid in Capital:			
Balance beginning of year	$ 8,938,679	$ 8,993,016	$ 10,474,688
Issuance of ordinary shares	1,387	572,708	1,109
Buybacks of ordinary shares	(402,747)	(666,705)	(521,664)
Transfer to non-controlling interest in equity of consolidated subsidiaries			(999,990)
Exercise of stock options	5,545	1,333	1,182
Share-based compensation expense	41,889	38,327	37,691
Balance end of year	$ 8,584,753	$ 8,938,679	$ 8,993,016
Accumulated Other Comprehensive Income (Loss):			
Balance beginning of year	$ 583,064	$ 100,795	$ (1,142,467)
Impact of adoption of new authoritative embedded derivative guidance, net of taxes			31,917
Change in net unrealized gains (losses) on investments, net of tax	841,213	446,427	997,066
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	46,163	25,269	44,314
Change in OTTI losses recognized in other comprehensive income, net of tax	67,280	39,456	124,906

Change in underfunded pension liability		(9,985)		(2,622)		(2,619)
Change in net unrealized gain (loss) on future policy reserves						(3,714)
Change in value of cash flow hedge		439		439		439
Foreign currency translation adjustments		(8,163)		(26,700)		50,953
Balance end of year	$	1,520,011	$	583,064	$	100,795
Retained Earnings (Deficit):						
Balance beginning of year	$	(113,241)	$	500,497	$	81,180
Impact of adoption of new authoritative embedded derivative guidance, net of taxes						(31,917)
Net income attributable to XL Group plc		651,134		(474,760)		603,550
Dividends on ordinary shares		(135,572)		(138,978)		(134,238)
Dividends on Redeemable Series C and Series E preference ordinary shares						(34,694)
Gain on redemption of Redeemable Series C preference ordinary shares						16,616
Balance end of year	$	402,321	$	(113,241)	$	500,497
Non-controlling Interest in Equity of Consolidated Subsidiaries:						
Balance beginning of year	$	1,344,472	$	1,002,296	$	2,305
Non-controlling interests contribution		1,500				
Non-controlling interests		113		(83)		4
Non-controlling interest share in change in accumulated other comprehensive income (loss)		240		(2,241)		(13)
Transfer from Series E preference ordinary shares and additional paid in capital						1,000,000
Issuance of Series D preference ordinary shares				350,000		
Purchase of Series D preference ordinary shares				(5,000)		
Purchase of Series E preference ordinary shares				(500)		
Balance end of year	$	1,346,325	$	1,344,472	$	1,002,296
Total Shareholders Equity	$	11,856,397	$	10,756,130	$	10,599,769

See accompanying Notes to Consolidated Financial Statements

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XL GROUP PLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(U.S. dollars in thousands)	**2012**	**2011**	**2010**
Cash flows provided by (used in) operating activities:			
Net income (loss)	$ 730,388	$ (403,883)	$ 643,381
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Net realized (gains) losses on investments	(14,098)	188,359	270,803
Net realized and unrealized (gains) losses on derivative instruments	(5,221)	10,738	33,843
Amortization of premiums (discounts) on fixed maturities	169,353	120,130	60,869
(Income) loss from investment and operating affiliates	(114,314)	(103,039)	(172,474)
Impairment of goodwill		429,020	
Share based compensation	47,472	41,225	44,057
Depreciation	57,280	49,800	40,423
Accretion of deposit liabilities	81,269	82,799	104,311
Changes in:			
Unpaid losses and loss expenses	(287,972)	243,040	(207,526)
Future policy benefit reserves	(187,400)	(171,618)	(197,570)
Unearned premiums	182,963	95,393	(133,955)
Premiums receivable	(127,633)	(31,286)	94,649
Unpaid losses and loss expenses recoverable	305,675	(2,168)	(74,242)
Ceded unearned premiums	14,923	21,532	83,246
Reinsurance balances receivable	162,280	(49,286)	201,479
Deferred acquisition costs	(649)	(41,881)	12,235
Reinsurance balances payable	48,159	(31,846)	(253,213)
Deferred tax asset net	(28,556)	(43,583)	104,111
Derivatives	7,252	93,796	123,027
Other assets	22,847	(24,747)	(68,513)
Other liabilities	50,342	(93,323)	(32,146)
Other	(58,254)	(51,970)	(82,039)
Total adjustments	$ 325,718	$ 731,085	$ (48,625)
Net cash provided by (used in) operating activities	$ 1,056,106	$ 327,202	$ 594,756

Cash flows provided by (used in) investing activities:			
Proceeds from sale of fixed maturities and short-term investments	$ 3,604,792	$ 5,091,375	$ 5,206,690
Proceeds from redemption of fixed maturities and short-term investments	4,579,651	3,595,922	2,851,815
Proceeds from sale of equity securities	221,617	205,736	115,839
Purchases of fixed maturities and short-term investments	(8,902,879)	(7,529,962)	(8,098,862)
Purchases of equity securities	(362,021)	(631,169)	(157,963)
Investment affiliates, net	(4,652)	136,281	319,108
Other investments, net	(79,101)	(36,080)	24,854
Net cash provided by (used in) investing activities	$ (942,593)	$ 832,103	$ 261,481

See accompanying Notes to Consolidated Financial Statements

XL GROUP PLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(U.S. dollars in thousands)	**2012**	**2011**	**2010**
Cash flows provided by (used in) financing activities:			
Proceeds from issuance of ordinary shares and exercise of stock options	$ 5,413	$ 576,333	$ 1,182
Proceeds from issuance of Series D preference ordinary shares		349,180	
Buybacks of ordinary shares	(402,930)	(667,022)	(522,024)
Repurchase of Redeemable Series C preference ordinary shares		(71,801)	(94,157)
Repurchase of Series D preference ordinary shares		(3,650)	
Repurchase of Series E preference ordinary shares		(465)	
Dividends paid on ordinary shares	(134,799)	(138,050)	(133,748)
Dividends paid on preference ordinary shares			(40,385)
Distributions to non-controlling interests	(78,987)	(71,483)	(37,392)
Proceeds from issuance of debt		395,859	
Contribution from non-controlling interest	1,500		
Repayment of debt	(600,000)	(575,000)	
Deposit liabilities	(134,950)	(152,617)	(646,819)
Net cash provided by (used in) financing activities	$ (1,344,753)	$ (358,716)	$ (1,473,343)
Effects of exchange rate changes on foreign currency cash	24,493	1,668	(3,723)
Increase (decrease) in cash and cash equivalents	$ (1,206,747)	$ 802,257	$ (620,829)
Cash and cash equivalents beginning of period	3,825,125	3,022,868	3,643,697
Cash and cash equivalents end of period	$ 2,618,378	$ 3,825,125	$ 3,022,868
Net taxes paid	$ 34,465	$ 106,666	$ 75,429
Interest paid on notes payable and debt	$ 116,689	$ 149,133	$ 162,086

See accompanying Notes to Consolidated Financial Statements

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

1. General

XL Group plc, through its operating subsidiaries (collectively the Company or XL), is a leading provider of insurance and reinsurance coverages to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. The Company and its various subsidiaries operate globally in 24 countries, through its three business segments: Insurance, Reinsurance and Life operations. These segments are further discussed in Note 4, Segment Information.

For periods prior to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to, and these financial statements include the accounts of, XLIT Ltd. (formerly, XL Capital Ltd), a Cayman Islands exempted company (XL-Cayman), and its consolidated subsidiaries. For periods subsequent to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to, and these financial statements include the accounts of, XL Group plc, an Irish public limited company (XL-Ireland), and its consolidated subsidiaries.

On July 1, 2010, XL-Ireland and XL-Cayman completed a redomestication transaction in which all of the ordinary shares of XL-Cayman were exchanged for all of the ordinary shares of XL-Ireland (the Redomestication). As a result, XL-Cayman became a wholly owned subsidiary of XL-Ireland. On July 23, 2010, the Irish High Court approved XL-Ireland s creation of distributable reserves, subject to the completion of certain formalities under Irish Company law. These formalities were completed in early August 2010.

2. Significant Accounting Policies

(a) Basis of Preparation and Consolidation

These consolidated financial statements include the accounts of the Company and all of its subsidiaries. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). To facilitate period-to-period comparisons, certain reclassifications have been made to prior year consolidated financial statement amounts to conform to current year presentation. There was no effect on net income from this change in presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company s most significant areas of estimation include:

unpaid losses and loss expenses and unpaid losses and loss expenses recoverable;

future policy benefit reserves;

valuation and other-than-temporary impairments of

investments;

income taxes;

reinsurance premium estimates; and

goodwill carrying value.

While management believes that the amounts included in the consolidated financial statements reflect the Company s best estimates and assumptions, actual results could differ from these estimates.

(b) Fair Value Measurements

Financial Instruments Subject to Fair Value Measurements

Accounting guidance over fair value measurements requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

2. Significant Accounting Policies (Continued)

(b) Fair Value Measurements (Continued)

between market participants at the measurement date (the exit price). Instruments that the Company owns (long positions) are marked to bid prices and instruments that the Company has sold but not yet purchased (short positions) are marked to offer prices. Fair value measurements are not adjusted for transaction costs.

Basis of Fair Value Measurement

Fair value measurements accounting guidance also establishes a fair value hierarchy that prioritizes the inputs to the respective valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). An asset or liability s classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The three levels of the fair value hierarchy are described further below:

Level 1 Quoted prices in active markets for identical assets or liabilities (unadjusted); no blockage factors.

Level 2 Other observable inputs (quoted prices in markets that are not active or inputs that are observable either directly or indirectly) include quoted prices for similar assets/liabilities (adjusted) other than quoted prices in Level 1; quoted prices in markets that are not active; or other inputs that are observable or can be derived

principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Unobservable inputs reflect the reporting entity s own assumptions about the assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Details on assets and liabilities that have been included under the requirements of authoritative guidance on fair value measurements to illustrate the bases for determining the fair values of these items held by the Company are detailed in each respective significant accounting policy section of this note.

Fair values of investments and derivatives are based on published market values if available, estimates of fair values of similar issues, or estimates of fair values provided by independent pricing services and brokers. Fair values of financial instruments for which quoted market prices are not available or for which the company believes current trading conditions represent distressed markets are based on estimates using present value or other valuation techniques. The fair values estimated using such techniques are significantly affected by the assumptions used, including the discount rates and the estimated amounts and timing of future cash flows. In such instances, the derived fair value estimates cannot be substantiated by comparison to independent markets and are not necessarily indicative of the amounts that would be realized in a current market exchange.

(c) Total Investments

Investments Available For Sale

Investments that are considered available for sale (comprised of the Company s fixed maturities, equity securities and short-term investments) are carried at fair value. The fair values for available for sale investments are generally sourced from third parties. The fair values of fixed income securities are based upon quoted market values where available, evaluated bid prices provided by third party pricing services (pricing services) where quoted market values are not available, or by reference to broker or underwriter

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

2. Significant Accounting Policies (Continued)

(c) Total Investments (Continued)

bid indications where pricing services do not provide coverage for a particular security. To the extent the Company believes current trading conditions represent distressed transactions, the Company may elect to utilize internally generated models. The pricing services use market approaches to valuations using primarily Level 2 inputs in the vast majority of valuations, or some form of discounted cash flow analysis, to obtain investment values for a small percentage of fixed income securities for which they provide a price. Pricing services indicate that they will only produce an estimate of fair value if there is objectively verifiable information available to produce a valuation. Standard inputs to the valuations provided by the pricing services listed in approximate order of priority for use when available include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. The pricing services may prioritize inputs differently on any given day for any security, and not all inputs listed are available for use in the evaluation process on any given day for each security evaluation; however, the pricing services also monitor market indicators, customer feedback through a price challenge process and industry and economic events. Information of this nature is a trigger to acquire further corroborating market data. When these inputs are not available, they identify buckets of similar securities (allocated by asset class types, sectors, sub-sectors, contractual cash flows/structure, and credit rating characteristics) and apply some form of matrix or other modeled pricing to determine an appropriate security value which represents their best estimate as to what a buyer in the marketplace would pay for a security in a current sale. While the Company receives values for the majority of the investment securities it holds from pricing services, it is ultimately management s responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements. It is common industry practice to utilize pricing services as a source for determining the fair values of investments where the pricing services are able to obtain sufficient market corroborating information to allow them to produce a valuation at a reporting date. In addition, in the majority of cases, although a value may be obtained from a particular pricing service for a security or class of similar securities, these values are corroborated against values provided by other pricing services.

Broker/dealer quotations are used to value fixed maturities where prices are unavailable from pricing services due to factors specific to the security such as limited liquidity, lack of current transactions, or trades only taking place in privately negotiated transactions. These are considered Level 3 valuations, as significant inputs utilized by brokers may be difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification.

Prices provided by independent pricing services and independent broker quotes can vary widely even for the same security. The use of different methodologies and assumptions may have a material effect on the estimated fair value amounts.

The net unrealized gain or loss on investments, net of tax, is included in accumulated other comprehensive income (loss).

Short-term investments include investments due to mature within one year from the date of purchase and are valued using the same external factors and in the same manner as fixed income securities.

Equity securities include investments in open end mutual funds and shares of publicly traded alternative funds. The fair value of equity securities is based upon quoted market values (Level 1), or monthly net asset value statements provided by the investment managers upon which subscriptions and redemptions can be executed (Level 2).

All investment transactions are recorded on a trade date basis. Realized gains and losses on sales of equities and fixed income investments are determined on a first-in, first-out basis. Investment income is recognized when earned and includes interest and dividend income together with the amortization of premium and discount on fixed maturities and short-term investments, and is recorded net of related investment expenses. Amortization of discounts on fixed maturities includes amortization to expected

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

2. Significant Accounting Policies (Continued)

(c) Total Investments (Continued)

recovery values for investments that have previously been recorded as other than temporarily impaired. For mortgage-backed securities, and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Prepayment fees or call premiums that are only payable to the Company when a security is called prior to its maturity are earned when received and reflected in net investment income.

Investments Held to Maturity

Investments classified as held to maturity include securities for which the Company has the ability and intent to hold to maturity and are carried at amortized cost. For details see Note 5, Investments.

Investments In Affiliates

Investments in which the Company has significant influence over the operating and financial policies of the investee are classified as investments in affiliates on the Company s balance sheet and are accounted for under the equity method of accounting. Under this method, the Company records its proportionate share of income or loss from such investments in its results for the period as well as its portion of movements in certain of the investee shareholders equity balances. When financial statements of the affiliate are not available on a timely basis to record the Company s share of income or loss for the same reporting periods as the Company, the most recently available financial statements are used. This lag in reporting is applied consistently.

The Company generally records its alternative and private equity fund affiliates on a one-month and three-month lag, respectively, and its operating affiliates on a three-month lag. Significant influence is generally deemed to exist where the Company has an investment of 20% or more in the common stock of a corporation or an investment of 3% or more in closed end funds, limited partnerships, LLCs or similar investment vehicles. Significant influence is considered for other strategic investments on a case-by-case basis. Investments in affiliates are not subject to fair value measurement guidance as they are not considered to be fair value measured investments under U.S. GAAP. However, impairments associated with investments in affiliates that are deemed to be other-than-temporary are calculated in accordance with fair value measurement guidance and appropriate disclosures included within the financial statements during the period the losses are recorded.

Other Investments

Contained within this asset class are equity interests in investment funds, limited partnerships and unrated tranches of collateralized debt obligations for which the Company does not have sufficient rights or ownership interests to follow the equity method of accounting. The Company accounts for equity securities that do not have readily determinable market values at estimated fair value as it has no significant influence over these entities. Also included within other investments are structured transactions which are carried at amortized cost.

Fair values for other investments, principally other direct equity investments, investment funds and limited partnerships, are primarily based on the net asset value provided by the investment manager, the general partner or the respective entity, recent financial information, available market data and, in certain cases, management judgment may be required. These entities generally carry their trading positions and investments, the majority of which have underlying securities valued using Level 1 or Level 2 inputs, at fair value as determined by their respective investment

managers; accordingly, these investments are generally classified as Level 2. Private equity investments are classified as Level 3. The net unrealized gain or loss on investments, net of tax, is included in Accumulated other comprehensive income (loss). Any

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

2. Significant Accounting Policies (Continued)

(c) Total Investments (Continued)

unrealized loss in value considered by management to be other-than-temporary is charged to income in the period that it is determined.

Overseas deposits include investments in private funds related to Lloyd s syndicates in which the underlying instruments are primarily cash equivalents. The funds themselves do not trade on an exchange and therefore are not included within available for sale securities. Also included in overseas deposits are restricted cash and cash equivalent balances held by Lloyd s syndicates for solvency purposes. Given the restricted nature of these cash balances, they are not included within the cash and cash equivalents line in the balance sheet. Each of these investment types is considered a Level 2 valuation.

The Company historically participated in structured transactions that include cash loans supporting project finance transactions, providing liquidity facility financing to a structured project deal in 2009 and the Company also invested in a payment obligation with an insurance company. These transactions are carried at amortized cost. For further details see Note 3, Fair Value Measurements, and Note 7, Other Investments.

(d) Premiums and Acquisition Costs

Insurance premiums written are recorded in accordance with the terms of the underlying policies. Reinsurance premiums written are recorded at the inception of the policy and are estimated based upon information received from ceding companies and any subsequent differences arising on such estimates are recorded in the period they are determined.

Premiums are earned on a pro-rata basis over the period the coverage is provided. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of policies in force. Net premiums earned are presented after deductions for reinsurance ceded, as applicable.

Mandatory reinstatement premiums are recognized and earned at the time a loss event occurs.

Life and annuity premiums from long duration contracts that transfer significant mortality or morbidity risks are recognized as revenue and earned when due from policyholders. Life and annuity premiums from long duration contracts that do not subject the Company to risks arising from policyholder mortality or morbidity are accounted for as investment contracts and presented within deposit liabilities.

The Company has periodically written retroactive loss portfolio transfer (LPT) contracts. These contracts are evaluated to determine whether they meet the established criteria for reinsurance accounting, and, if so, at inception, written premiums are fully earned and corresponding losses and loss expense recognized. The contracts can cause significant variances in gross premiums written, net premiums written, net premiums earned, and net incurred losses in the years in which they are written. Reinsurance contracts sold not meeting the established criteria for reinsurance accounting are recorded using the deposit method.

Acquisition costs, which vary with and are directly related to the acquisition of policies, consist primarily of commissions paid to brokers and cedants, and are deferred and amortized over the period that the premiums are earned. Acquisition costs are shown net of commissions earned on reinsurance ceded. Future earned premiums, the

anticipated losses and other costs (and in the case of a premium deficiency, investment income) related to those premiums, are also considered in determining the level of acquisition costs to be deferred.

(e) Reinsurance

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. Reinsurance premiums ceded are expensed (and any commissions recorded thereon are earned) on a monthly pro-rata basis over the period the reinsurance coverage is provided. Ceded unearned reinsurance premiums represent the portion of premiums ceded applicable to the unexpired term of

XL GROUP PLC
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2. Significant Accounting Policies (Continued)

(e) Reinsurance (Continued)

policies in force. Mandatory reinstatement premiums ceded are recorded at the time a loss event occurs. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Provisions are made for estimated unrecoverable reinsurance.

(f) Fee Income and Other

Fee income and other includes fees received for insurance and product structuring services provided and is earned over the service period of the contract. Any adjustments to fees earned or the service period are reflected in income in the period when determined.

(g) Other-Than-Temporary Impairments (OTTI) of Available for Sale and Held to Maturity Securities

The Company s process for identifying declines in the fair value of investments that are other-than-temporary involves consideration of several factors. These primary factors include (i) an analysis of the liquidity, business prospects and financial condition of the issuer including consideration of credit ratings, (ii) the significance of the decline, (iii) an analysis of the collateral structure and other credit support, as applicable, of the securities in question, and (iv) for debt securities, whether the Company intends to sell such securities. In addition, the authoritative guidance requires that OTTI for certain asset backed and mortgage backed securities is recognized if the fair value of the security is less than its discounted cash flow value and there has been a decrease in the present value of the expected cash flows since the last reporting period. Where the Company s analysis of the above factors results in the Company s conclusion that declines in fair values are other-than-temporary, the cost of the security is written down to discounted cash flow and a portion of the previously unrealized loss is therefore realized in the period such determination is made.

If the Company intends to sell an impaired debt security, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, the impairment is other-than-temporary and is recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost.

In instances in which the Company determines that a credit loss exists but the Company does not intend to sell the security, and it is not more likely than not that the Company will be required to sell the security before the anticipated recovery of its remaining amortized cost basis, the OTTI is separated into (1) the amount of the total impairment related to the credit loss and (2) the amount of the total impairment related to all other factors (i.e. the noncredit portion). The amount of the total OTTI related to the credit loss is recognized in earnings and the amount of the total OTTI related to all other factors is recognized in accumulated other comprehensive loss. The total OTTI is presented in the income statement with an offset for the amount of the total OTTI that is recognized in accumulated other comprehensive loss. Absent the intent or requirement to sell a security, if a credit loss does not exist, any impairment is considered to be temporary.

The noncredit portion of any OTTI losses on securities classified as available for sale is recorded as a component of other comprehensive income with an offsetting adjustment to the carrying value of the security. The fair value adjustment could increase or decrease the carrying value of the security. The noncredit portion of any OTTI losses recognized in accumulated other comprehensive loss for debt securities classified as held to maturity would be accreted over the remaining life of the debt security (in a pro rata manner based on the amount of actual cash flows received as a percentage of total estimated cash flows) as an increase in the carrying value of the security until the

security is sold, the security matures, or there is an additional OTTI that is recognized in earnings.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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2. Significant Accounting Policies (Continued)

(g) Other-Than-Temporary Impairments (OTTI) of Available for Sale and Held to Maturity Securities (Continued)

In periods subsequent to the recognition of an OTTI loss, the other-than-temporarily impaired debt security is accounted for as if it had been purchased on the measurement date of the OTTI at an amount equal to the previous amortized cost basis less the credit-related OTTI recognized in earnings. For debt securities for which credit-related OTTI is recognized in earnings, the difference between the new cost basis and the cash flows expected to be collected is accreted into interest income over the remaining life of the security in a prospective manner based on the estimated amount and timing of future estimated cash flows.

With respect to securities where the decline in value is determined to be temporary and the security s amortized cost is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of overall risk monitoring, changing information, market conditions generally and assessing value relative to other comparable securities. Day-to-day management of the Company s investment portfolio is outsourced to third party investment manager service providers. While these investment manager service providers may, at a given point in time, believe that the preferred course of action is to hold securities with unrealized losses that are considered temporary until such losses are recovered, the dynamic nature of the portfolio management may result in a subsequent decision to sell the security and realize the loss, based upon a change in market and other factors described above. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the Company s portfolio as available for sale.

There are risks and uncertainties associated with determining whether declines in the fair value of investments are other-than-temporary. These include subsequent significant changes in general economic conditions as well as specific business conditions affecting particular issuers, the Company s liability profile, subjective assessment of issue-specific factors (seniority of claims, collateral value, etc.), future financial market effects, stability of foreign governments and economies, future rating agency actions and significant disclosure of accounting, fraud or corporate governance issues that may adversely affect certain investments. In addition, significant assumptions and management judgment are involved in determining if the decline is other-than-temporary. If management determines that a decline in fair value is temporary, then a security s value is not written down at that time. However, there are potential effects upon the Company s future earnings and financial position should management later conclude that some of the current declines in the fair value of the investments are other-than-temporary declines. For further details on the factors considered in evaluation of OTTI see Note 5, Investments.

(h) Derivative Instruments

The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value. The changes in fair value of derivatives are shown in the consolidated statement of income as net realized and unrealized gains and losses on derivative instruments unless the derivatives are designated as hedging instruments. The accounting for derivatives which are designated as hedging instruments is discussed below. Changes in fair value of derivatives may create volatility in the Company s results of operations from period to period. Amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) are offset against net fair value amounts recognized in the consolidated balance sheet for derivative instruments executed with the same counterparty under the same netting arrangement to the extent that the Company intends to settle the amounts on a net basis.

Derivative contracts can be exchange-traded or over-the-counter (OTC). Exchange-traded derivatives (futures and options) typically fall within Level 1 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources where an understanding of the inputs

XL GROUP PLC
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2. Significant Accounting Policies (Continued)

(h) Derivative Instruments (Continued)

utilized in arriving at the valuations is obtained. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms and specific risks inherent in the instrument as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, interest rate swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. Such instruments comprise the majority of derivatives held by the Company and are typically classified within Level 2 of the fair value hierarchy.

Certain OTC derivatives trade in less liquid markets with limited pricing information, or required model inputs which are not directly market corroborated, which causes the determination of fair value for these derivatives to be inherently more subjective. Accordingly, such derivatives are classified within Level 3 of the fair value hierarchy. The valuations of less standard or liquid OTC derivatives are typically based on Level 1 and/or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Level 1 and Level 2 inputs are regularly updated to reflect observable market changes. Level 3 inputs are only changed when corroborated by evidence such as similar market transactions, pricing services and/or broker or dealer quotations. The Company conducts its non-hedging derivatives activities in three main areas: investment related derivatives, credit derivatives and other non-investment related derivatives.

The Company uses derivative instruments, primarily interest rate swaps, to manage the interest rate exposure associated with certain assets and liabilities. These derivatives are recorded at fair value. On the date the derivative contract is entered into, the Company may designate the derivative as a hedge of the fair value of a recognized asset or liability (fair value hedge); a hedge of the variability in cash flows of a forecasted transaction or of amounts to be received or paid related to a recognized asset or liability (cash flow hedge); or a hedge of a net investment in a foreign operation; or the Company may not designate any hedging relationship for a derivative contract. In addition, the Company previously wrote a number of resettable strike swaps contracts relating to an absolute return index and diversified basket of funds, all of which are recorded within Investment Related Derivatives Financial Market Exposures. These resettable strike swaps all expired during 2011.

Fair Value Hedges

Changes in the fair value of a derivative that is designated and qualifies as a fair value hedge, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings (through net realized and unrealized gains and losses on derivative instruments) with any differences between the net change in fair value of the derivative and the hedged item representing the hedge ineffectiveness. Periodic derivative net coupon settlements are recorded in net investment income with the exception of hedges of Company issued debt, which are recorded in interest expense. The Company may designate fair value hedging relationships where interest rate swaps are used to hedge the changes in fair value of certain fixed rate liabilities and fixed maturity securities due to changes in the designated benchmark interest rate.

Cash Flow Hedges

Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in accumulated other comprehensive income (AOCI) and are reclassified into earnings when the variability of the cash flow of the hedged item impacts earnings. Gains and losses on derivative contracts that are reclassified from AOCI to current period earnings are included in the line item in the consolidated statements of operations in which the cash flows of the hedged item are recorded. Any hedge ineffectiveness is recorded immediately in current period earnings as net realized and unrealized gains and

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2. Significant Accounting Policies (Continued)

(h) Derivative Instruments (Continued)

losses on derivative instruments. Periodic derivative net coupon settlements are recorded in net investment income. The Company may designate cash flow hedging relationships where interest rate swaps are used to mitigate interest rate risk associated with anticipated issuances of debt or other forecasted transactions.

Hedges of the Net Investment in a Foreign Operation

Changes in fair value of a derivative used as a hedge of a net investment in a foreign operation, to the extent effective as a hedge, are recorded in the foreign currency translation adjustments account within AOCI. Cumulative changes in fair value recorded in AOCI are reclassified into earnings upon the sale or complete or substantially complete liquidation of the foreign entity. Any hedge ineffectiveness is recorded immediately in current period earnings as net realized and unrealized gains and losses on derivative instruments.

Hedge Documentation and Effectiveness Testing

To qualify for hedge accounting treatment, a derivative must be highly effective in mitigating the designated changes in value or cash flow of the hedged item. At hedge inception, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking each hedge transaction. The documentation process includes linking derivatives that are designated as fair value, cash flow, or net investment hedges to specific assets or liabilities on the balance sheet or to specific forecasted transactions. The Company also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. In addition, certain hedging relationships are considered highly effective if the changes in the fair value or discounted cash flows of the hedging instrument are within a ratio of 80-125% of the inverse changes in the fair value or discounted cash flows of the hedged item. Hedge ineffectiveness is measured using qualitative and quantitative methods. Qualitative methods may include comparison of critical terms of the derivative to the hedged item. Depending on the hedging strategy, quantitative methods may include the Change in Variable Cash Flows Method, the Change in Fair Value Method, the Hypothetical Derivative Method or the Dollar Offset Method.

Discontinuance of Hedge Accounting

The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item; the derivative is dedesignated as a hedging instrument; or the derivative expires or is sold, terminated or exercised. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, the derivative continues to be carried at fair value on the balance sheet with changes in its fair value recognized in current period earnings through net realized and unrealized gains and losses on derivative instruments. When hedge accounting is discontinued because the Company becomes aware that it is not probable that the forecasted transaction will occur, the derivative continues to be carried on the balance sheet at its fair value, and gains and losses that were accumulated in AOCI are recognized immediately in earnings.

(i) Cash Equivalents

Cash equivalents include fixed interest deposits placed with a maturity of under 90 days when purchased. Bank deposits are not considered to be fair value measurements and as such are not subject to the authoritative guidance on fair value measurement disclosures. Money market funds are classified as Level 1 as these instruments are considered actively traded; however, certificates of deposit are classified as Level 2.

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2. Significant Accounting Policies (Continued)

(j) Foreign Currency Translation

Assets and liabilities of foreign operations whose functional currency is not the U.S. dollar are translated at prevailing year end exchange rates. Revenue and expenses of such foreign operations are translated at average exchange rates during the year. The net effect of the translation adjustments for foreign operations, net of applicable deferred income taxes, as well as any gains or losses on intercompany balances for which settlement is not planned or anticipated in the foreseeable future, are included in accumulated other comprehensive income (loss).

Monetary assets and liabilities denominated in currencies other than the functional currency of the applicable entity are revalued at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the exchange rate on the date the transaction occurs with the resulting foreign exchange gains and losses on settlement or revaluation recognized in income.

(k) Goodwill and Other Intangible Assets

The Company has recorded goodwill in connection with various acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with accounting guidance for goodwill and other intangible assets, the Company tests goodwill for potential impairment annually as of June 30, during the third quarter, and between annual tests if an event occurs or circumstances change that may indicate that potential exists for the fair value of a reporting unit to be reduced to a level below its carrying amount. For further details on the factors considered in the goodwill impairment evaluation see Note 8, Goodwill and Other Intangible Assets.

The Company s other intangible assets consist of both amortizable and non-amortizable intangible assets. The Company s amortizable intangible assets consist primarily of acquired customer relationships and acquired software. All of the Company s amortizable intangible assets are carried at net book value and are amortized over their estimated useful lives. The amortization periods approximate the periods over which the Company expects to generate future net cash inflows from the use of these assets. Accordingly, customer relationships are amortized over a useful life of 10 years and acquired software is amortized over a useful life of 5 years. The Company s policy is to amortize intangibles on a straight-line basis.

All of the Company s amortizable intangible assets, as well as other amortizable or depreciable long-lived assets such as premises and equipment, are subject to impairment testing in accordance with authoritative guidance for the impairment or disposal of long-lived assets when events or conditions indicate that the carrying value of an asset may not be fully recoverable from future cash flows.

The Company s indefinite lived intangible assets consist primarily of acquired insurance and reinsurance licenses. These assets are deemed to have indefinite useful lives and are therefore not subject to amortization. In accordance with the authoritative guidance on intangibles and goodwill and other assets under GAAP, all of the Company s non-amortized intangible assets are subject to a test for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Pursuant to the authoritative guidance, if the carrying value of a non-amortized intangible asset is in excess of its fair value, the asset must be written down to its fair value through the recognition of an impairment charge to earnings.

(l) Losses and Loss Expenses

Unpaid losses and loss expenses include reserves for reported unpaid losses and loss expenses and for losses incurred but not reported. The reserve for reported unpaid losses and loss expenses for the Company s property and casualty operations is established by management based on claims reported from insureds or amounts reported from ceding companies, and represent the estimated ultimate cost of events or conditions that have been reported to or specifically identified by the Company.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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2. Significant Accounting Policies (Continued)

(l) Losses and Loss Expenses (Continued)

The reserve for losses incurred but not reported is estimated by management based on loss development patterns determined by reference to the Company s underwriting practices, the policy form, type of program and historical experience. The Company s actuaries employ a variety of generally accepted methodologies to determine estimated ultimate loss reserves, including the Bornhuetter-Ferguson incurred loss method and frequency and severity approaches.

Certain workers compensation and certain U.K. motor liability claims liabilities are considered fixed and determinable and are discounted.

Management believes that the reserves for unpaid losses and loss expenses are sufficient to cover losses that fall within coverages assumed by the Company. However, there can be no assurance that losses will not exceed the Company s total reserves. The methodology of estimating loss reserves is periodically reviewed to ensure that the assumptions made continue to be appropriate and any adjustments resulting from such reviews are reflected in income in the year in which the adjustments are made.

(m) Deposit Liabilities

Contracts entered into by the Company that are not deemed to transfer significant underwriting and/or timing risk are accounted for as deposits, whereby liabilities are initially recorded at an amount equal to the assets received. The Company uses a portfolio rate of return of equivalent duration to the liabilities in determining risk transfer. An initial accretion rate is established based on actuarial estimates whereby the deposit liability is increased to the estimated amount payable over the term of the contract.

The deposit accretion rate is the rate of return required to fund expected future payment obligations (this is equivalent to the best estimate of future cash flows), which are determined actuarially based upon the nature of the underlying indemnifiable losses. Accretion of the liability is recorded as interest expense.

The Company periodically reassesses the estimated ultimate liability. Any changes to this liability are reflected as adjustments to interest expense to reflect the cumulative effect of the period the contract has been in force, and by an adjustment to the future accretion rate of the liability over the remaining estimated contract term.

(n) Future Policy Benefit Reserves

The Company estimates the present value of future policy benefits related to long duration contracts using assumptions for investment yields, mortality, and expenses, including a provision for adverse deviation.

The assumptions used to determine future policy benefit reserves are best estimate assumptions that are determined at the inception of the contracts and are locked-in throughout the life of the contract unless a premium deficiency develops. As the experience on the contracts emerges, the assumptions are reviewed. If such review would produce reserves in excess of those currently held, then the lock-in assumptions will be revised and a claim and policy benefit is recognized at that time.

Certain life insurance and annuity contracts provide the holder with a guarantee that the benefit received upon death will be no less than a minimum prescribed amount. The contracts are accounted for in accordance with the authoritative guidance on Accounting and Reporting by Insurance Enterprises for Certain Long- Duration Contracts and for Separate Accounts, which requires that the best estimate of future experience be combined with actual experience to determine the benefit ratio used to calculate the policy benefit reserve.

(o) Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes reflect the net tax effect of temporary differences between the carrying

XL GROUP PLC
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2. Significant Accounting Policies (Continued)

(o) Income Taxes (Continued)

amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The deferral of tax losses is evaluated based upon management s estimates of the future profitability of the Company s taxable entities based on current forecasts and the period for which losses may be carried forward. A valuation allowance is established for any portion of a deferred tax asset that management believes will not be realized. The Company continues to evaluate income generated in future periods by its subsidiaries in different jurisdictions in determining the recoverability of its deferred tax asset. If it is determined that future income generated by these subsidiaries is insufficient to cause the realization of the net operating losses within a reasonable period, a valuation allowance is established at that time.

(p) Stock Plans

The Company adopted authoritative guidance on the fair value recognition provisions for accounting for stock-based compensation, under the prospective method for options granted subsequent to January 1, 2003. Prior to 2003, the Company accounted for options under the disclosure-only provisions of the guidance and no stock-based employee compensation cost was included in net income as all options granted had an exercise price equal to the market value of the Company s ordinary shares on the date of the grant. At December 31, 2012, the Company had several stock-based Performance Incentive Programs, which are described more fully in Note 18, Share Capital. Stock-based compensation issued under these plans generally has a life of not longer than ten years and vests as set forth at the time of grant. Awards currently vest annually over three or four years from the date of grant. The Company recognizes compensation costs for stock-based awards on a straight-line basis over the requisite service period (usually the vesting period) for each award.

Share-based payments to employees, including grants of employee stock options, are recognized in the financial statements over the vesting period based on their grant date fair values.

Authoritative guidance requires that compensation costs be recognized for unvested stock-based compensation awards over the period through the date that the employee is no longer required to provide future services to earn the award, rather than over the explicit service period. Accordingly, the Company follows a policy of recognizing compensation cost to coincide with the date that the employee is eligible to retire, rather than the actual retirement date, for all stock-based compensation granted.

(q) Per Share Data

Basic earnings per ordinary share is based on weighted average ordinary shares outstanding and excludes any dilutive effects of options and convertible securities. Diluted earnings per ordinary share assumes the exercise of all dilutive stock options and conversion of convertible securities where the contingency for conversion has occurred or been satisfied.

(r) Recent Accounting Pronouncements

In October 2010, the FASB issued an accounting standards update to address disparities in practice regarding the interpretation of which costs relating to the acquisition of new and renewal insurance contracts qualify for deferral. The provisions of the guidance specify that only costs that are related directly to the successful acquisition of new and

renewal insurance contracts may be capitalized. These include incremental direct costs of contract acquisition and certain other costs related directly to underwriting activities. Incremental direct costs of contract acquisition are those that result directly from and are essential to a contract transaction, and would not have been incurred by the insurance entity had the transaction not occurred. Administrative costs, rent, depreciation, occupancy, equipment and all other general overhead costs are considered indirect costs and should be charged to expense as incurred. On January 1, 2012, the

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2. Significant Accounting Policies (Continued)

(r) Recent Accounting Pronouncements (Continued)

Company adopted this guidance on a retrospective basis for all fiscal years presented, and interim periods within those years. The impact of adoption was a reduction in deferred acquisition costs of approximately $21 million, a reduction in deferred tax liabilities of approximately $7 million, and a corresponding reduction in opening retained earnings of approximately $14 million within the Company s December 31, 2011 balance sheet. The adoption of this guidance did not have an impact on the Company s consolidated statements of income or comprehensive income.

In May 2011, the FASB issued an accounting standards update to amend existing requirements for fair value measurements and disclosures. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy, requiring quantitative and qualitative information to be disclosed related to: (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset s highest and best use. The guidance requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value, but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for fair value measurements of financial assets and liabilities, as well as instruments classified in shareholders equity. The Company adopted this guidance from January 1, 2012; however, it impacted disclosure only and did not have an impact on the Company s financial condition or results of operations. See Note 3, Fair Value Measurements, for these updated disclosures.

In June 2011, the FASB issued an accounting standards update concerning the presentation of comprehensive income in financial statements. This guidance allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income only as part of the statement of changes in shareholders equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company adopted the guidance from January 1, 2012; however, it did not have an impact on the Company s disclosure, financial condition or results of operations or cash flows. In February 2013, the FASB issued an additional accounting standards update related to this topic that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The guidance does not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments are effective prospectively from January 1, 2013. As this guidance is disclosure-related only, its adoption will not impact the Company s financial condition, results of operations, or cash flows.

In September 2011, the FASB issued an accounting standards update to simplify how entities test goodwill for impairment, by allowing an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting entity is less than its carrying amount, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test required under U.S. GAAP accounting rules. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of a reporting unit as compared to its carrying value meets the threshold, then performing the two-step impairment step is unnecessary. In other circumstances, performance of the two-step test is required. The guidance also eliminates the option for an entity to carry forward its detailed calculation of a reporting unit s fair value

in certain situations. The Company adopted this guidance from January 1, 2012. It did not have an impact on the Company s consolidated financial condition, results of operations, or cash flows.

2. Significant Accounting Policies (Continued)

(r) Recent Accounting Pronouncements (Continued)

In December 2011, the FASB issued an accounting standards update requiring additional disclosures about financial instruments and derivatives that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. In January 2013, the FASB issued an additional accounting standards update related to this topic clarifying that the disclosures would apply only to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions, each to the extent that they met one of the two conditions provided in the initial accounting standard. This guidance will be effective on January 1, 2013, with retrospective presentation of the new disclosures required. As this guidance is disclosure-related only and does not amend the existing balance sheet offsetting guidance, the adoption of this guidance will not impact the Company s financial condition, results of operations, or cash flows.

In July 2012, the FASB issued an accounting standards update to simplify how entities test indefinite-lived intangible assets for impairment. Under this new guidance, an entity is allowed the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of the intangible asset as compared to its carrying value meets the threshold, it may bypass the existing requirements to perform a full quantitative impairment test on the intangible asset, a test which otherwise would have to be performed annually, at a minimum. The guidance was effective during the fourth quarter of 2012. The adoption of this guidance did not have an impact on the Company s consolidated financial condition, results of operations or cash flows.

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3. Fair Value Measurements

(a) Fair Value Summary

The following tables set forth the Company s assets and liabilities that were accounted for at fair value at December 31, 2012 and December 31, 2011 by level within the fair value hierarchy. For further information, see Note 2 (b), Significant Accounting Policies Fair Value Measurements :

December 31, 2012 *(U.S. dollars in thousands)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Collateral and Counterparty Netting**	**Balance a December 2012**
Assets					
U.S. Government and Government-Related/Supported	$	$ 2,034,617	$	$	$ 2,034
Corporate (1) (2)		10,451,902	30,098		10,482
Residential mortgage-backed securities Agency (RMBS Agency)		5,223,488	32,005		5,255
Residential mortgage-backed securities Non-Agency (RMBS Non-Agency)		647,617	116		647
Commercial mortgage-backed securities (CMBS)		1,051,904	25,347		1,077
Collateralized debt obligations (CDO)		8,080	701,736		709
Other asset-backed securities (2)		1,452,583	18,128		1,470
U.S. States and political subdivisions of the States		1,911,017			1,911
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported		4,258,282			4,258
Total fixed maturities, at fair value	$	$ 27,039,490	$ 807,430	$	$ 27,846
Equity securities, at fair value (3)	253,957	395,402			649
Short-term investments, at fair value (4)		322,703			322

Total investments available for sale	$	253,957	$	27,757,595	$	807,430	$		$	28,818
Cash equivalents (5)		1,596,376		408,292						2,004
Other investments (6)				792,483		115,272				907
Other assets (7)				17,837				12,130		29
Total assets accounted for at fair value	$	1,850,333	$	28,976,207	$	922,702	$	12,130	$	31,761
Liabilities										
Financial instruments sold, but not yet purchased (8)	$		$	26,235	$		$		$	26
Other liabilities (7)				23,376		36,247				59
Total liabilities accounted for at fair value	$		$	49,611	$	36,247	$		$	85

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(a) Fair Value Summary (Continued)

December 31, 2011 *(U.S. dollars in thousands)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Collateral and Counterparty Netting**	**Balan Decemb 201**
Assets					
U.S. Government and Government-Related/Supported	$	$ 1,990,983	$	$	$ 1,9
Corporate (1) (2)		10,084,804	23,818		10,1
RMBS Agency		5,347,365	32,041		5,3
RMBS Non-Agency		641,815			6
CMBS		974,835			9
CDO		7,751	650,851		6
Other asset-backed securities (2)		1,323,697	16,552		1,3
U.S. States and political subdivisions of the States		1,797,378			1,7
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported		3,298,135			3,2
Total fixed maturities, at fair value (2)	$	$ 25,466,763	$ 723,262	$	$ 26,1
Equity securities, at fair value (3)	239,175	229,022			4
Short-term investments, at fair value (4)		359,063			3
Total investments available for sale	$ 239,175	$ 26,054,848	$ 723,262	$	$ 27,0
Cash equivalents (5)	1,686,101	1,068,264			2,7
Other investments (6)		547,598	113,959		6
Other assets (7)		143,622		(77,888)	
Total assets accounted for at fair value	$ 1,925,276	$ 27,814,332	$ 837,221	$ (77,888)	$ 30,4

Liabilities					
Financial instruments sold, but not yet purchased (8)	$	$ 20,844	$	$	$
Other liabilities (7)		16,871	42,644	(809)	
Total liabilities accounted for at fair value	$	$ 37,715	$ 42,644	$ (809)	$

(1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, had a fair value of $194.3 million and $266.0 million and an amortized cost of $194.8 million and $297.7 million at December 31, 2012 and December 31, 2011, respectively. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(2) The Company invests in covered bonds issued by financial institutions (Covered Bonds). Covered Bonds are senior secured debt instruments issued by financial institutions and backed by over-collateralized pools of public sector or mortgage loans. At December 31, 2012, Covered Bonds within Total fixed maturities with a fair value of $647.1 million are included within Other

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(a) Fair Value Summary (Continued)

asset-backed securities to align the Company s classification to market indices. At December 31, 2011, Covered Bonds within Total fixed maturities with a fair value of $353.9 million were reclassified from Corporate to Other asset-backed securities to conform to current period presentation.

(3) Included within Equity securities are investments in fixed income funds with a fair value of $101.9 million and $91.6 million at December 31, 2012 and December 31, 2011, respectively.

(4) Short-term investments consist primarily of Corporate securities and U.S. and Non-U.S. Government and Government-Related/Supported securities.

(5) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to fair value measurement guidance.

(6) The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments, which totaled $312.1 million at December 31, 2012 and $323.7 million at December 31, 2011, are carried at amortized cost. For further details regarding the nature of Other investments and related features see Note 7, Other Investments, to the Consolidated Financial Statements.

(7) Other assets and other liabilities include derivative instruments. The derivative balances included in each category are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under a netting agreement. In addition, at December 31, 2012 the Company paid net cash collateral related to these derivative positions of $12.1 million. The assets related to the net collateral paid were recorded as Other assets within the balance sheet. At December 31, 2011, the Company held net cash collateral of $77.1 million. The collateral balance was included within Cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative asset within the balance sheet as appropriate under the netting agreement. The fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.

(8) Financial instruments sold, but not yet purchased, represent short sales and are included within Payable for investments purchased on the balance sheet.

(b) Level 3 Assets and Liabilities

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables present a reconciliation of the beginning and ending balances for the year ended December 31, 2012 and 2011 for all financial assets and liabilities measured at fair value using significant unobservable inputs (Level 3) at December 31, 2012 and 2011, respectively. The tables do not include gains or losses that were reported in Level 3 in prior periods for assets that were transferred out of Level 3 prior to December 31, 2012 and 2011. Gains and losses for assets and liabilities classified within Level 3 in the table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Level 1 and 2 financial instruments entered into by the Company that are either economically hedged by certain exposures to the Level 3 positions or that hedge the exposures in Level 3 positions.

In general, Level 3 assets include securities for which values were obtained from brokers where either significant inputs were utilized in determining the values that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification. Transfers into or out of Level 3 primarily arise as a result of the valuations utilized by the Company

changing between either those provided by independent pricing services that do not contain significant observable inputs, or other valuations sourced from brokers that are considered Level 3.

There were no significant transfers between Level 1 and Level 2 during the years ended December 31, 2012 and 2011.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(b) Level 3 Assets and Liabilities (Continued)

(U.S. dollars in thousands)	Level 3 Assets and Liabilities Year Ended December 31, 2012				
	Corporate	**RMBS Agency**	**RMBS Non Agency**	**CMBS**	**CDO**
Balance, beginning of period	$ 23,818	$ 32,041	$	$	$ 650,851
Realized gains (losses)	4	(15)			(894)
Movement in unrealized gains (losses)	100	27		20	109,282
Purchases and issuances	10,278			25,546	
Sales and settlements	(282)	(6,307)		(219)	(57,032)
Transfers into Level 3	819	21,249	116		
Transfers out of Level 3	(4,639)	(14,990)			(471)
Balance, end of period	$ 30,098	$ 32,005	$ 116	$ 25,347	$ 701,736
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 122	$ 10	$	$ 20	$ 104,474

(U.S. dollars in thousands)	Level 3 Assets and Liabilities Year Ended December 31, 2012					
	Other asset-backed securities	**Non-US Sovereign Government,**	**Short-term investments**	**Other investments**	**Derivative Contracts**	**Net**

		Provincial, Supranational and Government Related/Supported			
Balance, beginning of period	$ 16,552	$	$	$ 113,959	$ (42,644)
Realized gains (losses)	6,768			5,083	
Movement in unrealized gains (losses)	(2,784)			7,802	6,397
Purchases and issuances	8,753			7,375	
Sales and settlements	(16,094)			(18,637)	
Transfers into Level 3	4,933			5	
Transfers out of Level 3				(315)	
Balance, end of period	$ 18,128	$	$	$ 115,272	$ (36,247)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ (154)	$	$	$ 5,038	$ 6,397

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(b) Level 3 Assets and Liabilities (Continued)

	Level 3 Assets and Liabilities Year Ended December 31, 2011				
(U.S. dollars in thousands)	**Corporate**	**RMBS Agency**	**RMBS Non Agency**	**CMBS**	**CDO**
Balance, beginning of period	$ 36,866	$ 30,255	$ 4,964	$ 1,623	$ 721,572
Realized gains (losses)	(276)	(11)			(3,458)
Movement in unrealized gains (losses)	92	(145)			2,404
Purchases and issuances	14,840	6,176			2,379
Sales and settlements	(10,049)	(4,186)			(68,165)
Transfers into Level 3	2,105	2,655			1,886
Transfers out of Level 3	(19,760)	(2,703)	(4,964)	(1,623)	(5,767)
Balance, end of period	$ 23,818	$ 32,041	$	$	$ 650,851
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 92	$ (156)	$	$	$ (6,431)

Level 3 Assets and Liabilities
Year Ended

(U.S. dollars in thousands)

	December 31, 2011				
	Other asset-backed securities	Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported	Short-term investments	Other investments	Derivative Contracts Net
Balance, beginning of period	$ 24,650	$ 3,667	$	$ 133,717	$ (39,195)
Realized gains (losses)	(849)			11,592	
Movement in unrealized gains (losses)	6,896			14,108	(3,173)
Purchases and issuances				12,177	
Sales and settlements	(9,114)			(57,635)	(276)
Transfers into Level 3					
Transfers out of Level 3	(5,031)	(3,667)			
Balance, end of period	$ 16,552	$	$	$ 113,959	$ (42,644)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 12,334	$	$	$ 23,391	$ (3,173)

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(c) Fixed maturities and short-term investments

The Company s Level 3 assets consist primarily of CDOs, for which non-binding broker quotes are the primary source of the valuations. Sufficient information regarding the specific inputs utilized by the brokers was not available to support a Level 2 classification. The Company obtains the majority of broker quotes for these CDOs from third party investment managers who perform independent verifications of these valuations using pricing matrices based upon information gathered by market traders. In addition, for the majority of these securities, the Company compares the broker quotes to independent valuations obtained from third party pricing vendors, which may also consist of broker quotes, to assess if the prices received represent a reasonable estimate of the fair value. Although the Company does not have access to the specific unobservable inputs that may have been used in the fair value measurements of the CDO securities provided by brokers, we would expect that the significant inputs considered are prepayment rates, probability of default, loss severity in the event of default, recovery rates, liquidity premium and reinvestment rates. Significant increases (decreases) in any of those inputs in isolation could result in a significantly different fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

The remainder of the Level 3 assets relate to primarily to private equity investments and certain derivative positions as described below.

(d) Other investments

Included within the Other investments component of the Company s Level 3 valuations are private investments and alternative fund investments over which the Company is not deemed to have significant influence. The fair value of these investments is based upon net asset values received from the investment manager or general partner of the respective entity. The nature of the underlying investments held by the investee that form the basis of the net asset value include assets such as private business ventures and are such that significant Level 3 inputs are utilized in the determination of the individual underlying holding values and, accordingly, the fair value of the Company s investment in each entity is classified within Level 3. The Company has not adjusted the net asset values received; however, management incorporates factors such as the most recent financial information received, annual audited financial statements and the values at which capital transactions with the investee take place when applying judgment regarding whether any adjustments should be made to the net asset value in recording the fair value of each position. Investments in alternative funds included in Other investments utilize strategies including arbitrage, directional, event driven and multi-style. These funds potentially have lockup and gate provisions which may limit redemption liquidity. For further details regarding the nature of Other investments and related features see Note 7, Other Investments, for further details.

(e) Derivative instruments

Derivative instruments recorded within Other liabilities and classified within Level 3 include credit derivatives that provide protection on senior tranches of structured finance transactions where the value is obtained directly from the investment bank counterparty and sufficient information regarding the inputs utilized in such valuation was not obtained to support a Level 2 classification and guaranteed minimum income benefits (GMIB) embedded within one reinsurance contract. The majority of inputs utilized in the valuations of these types of derivative contracts are considered Level 1 or Level 2; however, each valuation includes at least one Level 3 input that was significant to the

valuation and, accordingly, the values are disclosed within Level 3.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

3. Fair Value Measurements (Continued)

(f) Non-recurring Fair Value Measurement

During the year ended December 31, 2011, the Company recorded a non-recurring fair value measurement relating to a goodwill impairment charge. This was a Level 3 fair value measurement as it reflected the Company s own assumptions about the assumptions that market participants would use in valuing the carried goodwill and was determined using a combination of discounted cash flow analysis and market value multiple based methodologies. See Note 8, Goodwill and Other Intangible Assets, for further information.

(g) Financial Instruments Not Carried at Fair Value

Authoritative guidance over disclosures about the fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, net receivable from investments sold, other assets, net payable for investments purchased, other liabilities and other financial instruments not included below approximated their fair values. The following table includes financial instruments for which the carrying value differs from the estimated fair values at December 31, 2012 and 2011. All of these fair value estimates are considered Level 2 fair value measurements. The fair values for fixed maturities held to maturity are provided by third party pricing vendors and significant valuation inputs for all other items included were based upon market data obtained from sources independent of the Company, and are subject to the same control environment previously described.

	December 31, 2012		December 31, 2011	
(U.S. dollars in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturities, held to maturity	$ 2,814,447	$ 3,262,804	$ 2,668,978	$ 2,895,688
Other investments structured transactions	312,122	293,813	323,705	297,124
Financial Assets	$ 3,126,569	$ 3,556,617	$ 2,992,683	$ 3,192,812
Deposit liabilities	$ 1,551,398	$ 1,878,499	$ 1,608,108	$ 1,809,812
Notes payable and debt	1,672,778	1,918,134	2,275,327	2,340,148
Financial Liabilities	$ 3,224,176	$ 3,796,633	$ 3,883,435	$ 4,149,960

The Company historically participated in structured transactions. Remaining structured transactions include cash loans supporting project finance transactions, providing liquidity facility financing to structured project deals and an investment in a payment obligation with an insurance company. These transactions are carried at amortized cost. The fair value of these investments held by the Company is determined through use of internal models utilizing reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Deposit liabilities include obligations under structured insurance and reinsurance transactions. For purposes of fair value disclosures, the Company determined the estimated fair value of the deposit liabilities by assuming a discount rate equal to the appropriate U.S. Treasury rate plus 100.3 basis points at December 31, 2012 and the appropriate U.S. Treasury rate plus 161.8 basis points at December 31, 2011. The discount rate incorporates the Company s own credit risk into the determination of estimated fair value.

The fair values of the Company s notes payable and debt outstanding were determined based on quoted market prices.

There are no significant concentrations of credit risk within the Company s financial instruments as defined in the authoritative guidance over disclosures of fair value of financial instruments not carried at fair value, which excludes certain financial instruments, particularly insurance contracts.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

4. Segment Information

The Company is organized into three operating segments: Insurance, Reinsurance and Life operations. The Company s general investment and financing operations are reflected in Corporate.

The Company evaluates the performance of both the Insurance and Reinsurance segments based on underwriting profit while the Life operations segment performance is based on contribution. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate investment assets by segment for its Property and Casualty (P&C) operations. Investment assets related to the Company s Life operations and certain structured products included in the Insurance and Reinsurance segments and Corporate are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from the applicable segment.

Year Ended December 31, 2012 *(U.S. dollars in thousands, except ratios)*		**Insurance**		**Reinsurance**		**Total P&C**		**Life Operations**		**Tot**
Gross premiums written	$	5,166,974	$	2,008,156	$	7,175,130	$	355,754	$	7,53
Net premiums written		4,072,513		1,884,508		5,957,021		324,432		6,28
Net premiums earned		3,924,640		1,841,342		5,765,982		324,459		6,09
Net losses and loss expenses		(2,691,056)		(1,074,426)		(3,765,482)		(486,198)		(4,25
Acquisition costs		(504,227)		(368,172)		(872,399)		(41,093)		(91
Operating expenses (1)		(754,306)		(157,657)		(911,963)		(9,336)		(92
Underwriting profit (loss)	$	(24,949)	$	241,087	$	216,138	$	(212,168)	$	
Net investment income						641,237		299,442		94
Net results from structured products (2)		20,980		(15,882)		5,098				
Net fee income and other (3)		(1,071)		2,493		1,422		426		

Net realized gains (losses) on investments			35,101	(21,003)	1
Contribution from P&C and Life Operations			$ 898,996	$ 66,697	$ 96
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					
Net income (loss) from investment fund affiliates and operating affiliates (4)					11
Exchange gains (losses)					(1
Corporate operating expenses					(20
Interest expense (5)					(10
Non-controlling interests					(7
Income tax					(3
Net income (loss) attributable to XL Group plc					$ 65
Ratios P&C operations: (6)					
Loss and loss expense ratio	68.6 %	58.4 %	65.3 %		
Underwriting expense ratio	32.0 %	28.5 %	31.0 %		
Combined ratio	100.6 %	86.9 %	96.3 %		

(1) Operating expenses exclude Corporate operating expenses, shown separately.

(2) The net results from P&C structured products include net investment income and interest expense of $71.7 million and $66.4 million, respectively.

(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business.

(4) The Company records the income related to the alternative funds and to

the private investment and operating fund affiliates on a one-month and three-month lag, respectively.

(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

4. Segment Information (Continued)

Year Ended December 31, 2011 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Tot**
Gross premiums written	$ 4,824,665	$ 2,073,619	$ 6,898,284	$ 394,555	$ 7,29
Net premiums written	3,707,664	1,725,724	5,433,388	362,362	5,79
Net premiums earned	3,663,727	1,663,385	5,327,112	363,018	5,69
Net losses and loss expenses	(2,951,413)	(1,126,978)	(4,078,391)	(535,074)	(4,61
Acquisition costs	(461,965)	(324,128)	(786,093)	(40,318)	(82
Operating expenses (1)	(683,814)	(176,167)	(859,981)	(9,311)	(86
Underwriting profit (loss)	$ (433,465)	$ 36,112	$ (397,353)	$ (221,685)	$ (61
Net investment income			745,138	318,061	1,06
Net results from structured products (2)	10,976	12,053	23,029		2
Net fee income and other (3)	(16,370)	3,903	(12,467)	219	(1
Net realized gains (losses) on investments			(98,360)	(89,999)	(18
Contribution from P&C and Life Operations			$ 259,987	$ 6,596	$ 26
Corporate & other:					

Net realized & unrealized gains (losses) on derivative instruments					(1
Net income (loss) from investment fund affiliates and operating affiliates (4)					10
Exchange gains (losses)					4
Corporate operating expenses					(16
Interest expense (5)					(15
Non-controlling interests					(7
Impairment of goodwill					(42
Income tax					(5
Net income (loss) attributable to XL Group plc				$	(47
Ratios P&C operations: (6)					
Loss and loss expense ratio	80.6 %	67.8 %	76.6 %		
Underwriting expense ratio	31.2 %	30.0 %	30.9 %		
Combined ratio	111.8 %	97.8 %	107.5 %		

(1) Operating expenses exclude Corporate operating

expenses, shown separately.

(2) The net results from P&C structured products include net investment income and interest expense of $74.6 million and $51.5 million, respectively.

(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.

(4) The Company records the income related to the alternative funds and to the private investment and

operating fund affiliates on a one-month and three-month lag, respectively.

(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

4. Segment Information (Continued)

Year Ended December 31, 2010 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Corpor**
Gross premiums written	$ 4,418,380	$ 1,842,951	$ 6,261,331	$ 411,938	$
Net premiums written	3,461,150	1,538,438	4,999,588	382,075	
Net premiums earned	3,529,138	1,501,999	5,031,137	382,924	
Net losses and loss expenses	(2,505,502)	(706,298)	(3,211,800)	(513,833)	
Acquisition costs	(418,146)	(321,008)	(739,154)	(49,104)	
Operating expenses (1)	(642,103)	(175,586)	(817,689)	(10,470)	
Underwriting profit (loss)	$ (36,613)	$ 299,107	$ 262,494	$ (190,483)	$
Net investment income			803,358	313,172	
Net results from structured products (2)	14,696	3,075	17,771		9,8
Net fee income and other (3)	(15,564)	2,488	(13,076)	249	
Net realized gains (losses) on investments			(206,877)	(54,444)	(9,4
Contribution from P&C and Life Operations			$ 863,670	$ 68,494	$
Corporate & other:					

Net realized & unrealized gains (losses) on derivative instruments				(33,
Net income (loss) from investment fund affiliates and operating affiliates (4)				172,
Exchange gains (losses)				10,
Corporate operating expenses				(92,
Interest expense (5)				(159,
Non-controlling interests				(39,
Loss on settlement of guarantee				(23,
Income tax				(162,
Net income (loss) attributable to XL Group plc				
Ratios P&C operations: (6)				
Loss and loss expense ratio	71.0 %	47.0 %	63.8 %	
Underwriting expense ratio	30.0 %	33.1 %	31.0 %	
Combined ratio	101.0 %	80.1 %	94.8 %	

(1) Operating expenses exclude Corporate

operating expenses, shown separately.

(2) The net results from P&C and Corporate structured products include net investment income, interest expense and operating expenses of $69.0 million, $52.9 million and $1.6 million (credit) and $12.5 million, $1.7 million and $1.0 million, respectively.

(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.

(4) The Company records the income related to the alternative funds and to the private investment and operating fund affiliates on a one-month and three-month lag, respectively.

(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

4. Segment Information (Continued)

The following tables summarize the Company s net premiums earned by line of business:

Year Ended December 31, 2012 *(U.S. dollars in thousands)*	**Insurance**	**Reinsurance**	**Life Operations**	**Total**
P&C Operations:				
Professional	$ 1,350,328	$ 213,322	$	$ 1,563,650
Casualty	1,157,909	311,160		1,469,069
Property catastrophe		463,977		463,977
Property	489,743	613,295		1,103,038
Marine, energy, aviation and satellite		147,370		147,370
Specialty	708,564			708,564
Other (1)	218,096	92,218		310,314
Total P&C Operations	$ 3,924,640	$ 1,841,342	$	$ 5,765,982
Life Operations:				
Annuity	$	$	$ 126,912	$ 126,912
Other Life			197,547	197,547
Total Life Operations	$	$	$ 324,459	$ 324,459
Total	$ 3,924,640	$ 1,841,342	$ 324,459	$ 6,090,441
Year Ended December 31, 2011				
P&C Operations:				
Professional	$ 1,287,231	$ 213,949	$	$ 1,501,180
Casualty	998,326	256,853		1,255,179
Property catastrophe		387,523		387,523
Property	464,576	587,611		1,052,187
Marine, energy, aviation and satellite		130,855		130,855
Specialty	702,604			702,604
Other (1)	210,990	86,594		297,584
Total P&C Operations	$ 3,663,727	$ 1,663,385	$	$ 5,327,112

Life Operations:								
Annuity	$		$		$	132,232	$	132,232
Other Life						230,786		230,786
Total Life Operations	$		$		$	363,018	$	363,018
Total	$	3,663,727	$	1,663,385	$	363,018	$	5,690,130
Year Ended December 31, 2010								
P&C Operations:								
Professional	$	1,316,173	$	222,720	$		$	1,538,893
Casualty		879,287		219,154				1,098,441
Property catastrophe				323,588				323,588
Property		416,806		534,422				951,228
Marine, energy, aviation and satellite				88,855				88,855
Specialty		682,518						682,518
Other (1)		234,354		113,260				347,614
Total P&C Operations	$	3,529,138	$	1,501,999	$		$	5,031,137
Life Operations:								
Annuity	$		$		$	255,905	$	255,905
Other Life						127,019		127,019
Total Life Operations	$		$		$	382,924	$	382,924
Total	$	3,529,138	$	1,501,999	$	382,924	$	5,414,061

(1) Other within the Insurance segment includes: excess and surplus, surety, structured indemnity and certain

other discontinued lines. Other within the Reinsurance segment includes: whole account contracts, surety and other lines.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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4. Segment Information (Continued)

The following table shows an analysis of the Company s net premiums written by geographical location of subsidiary where the premium is written for the years ended December 31:

P&C Operations: *(U.S. dollars in thousands)*	**2012**	**2011**	**2010**
Bermuda	$ 644,566	$ 572,825	$ 561,514
United States	2,626,856	2,320,274	2,143,240
Europe and other	2,685,599	2,540,289	2,294,834
Total P&C operations	$ 5,957,021	$ 5,433,388	$ 4,999,588
Life Operations: *(U.S. dollars in thousands)*			
Bermuda	$ 62,660	$ 75,219	$ 79,033
Europe and other	261,772	287,143	303,042
Total Life operations	$ 324,432	$ 362,362	$ 382,075

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments

(a) Fixed Maturities, Short-Term Investments and Equity Securities

Amortized Cost and Fair Value Summary

The cost (amortized cost for fixed maturities and short-term investments), fair value, gross unrealized gains and gross unrealized (losses), including, OTTI recorded in accumulated other comprehensive income (AOCI) of the Company s available for sale (AFS) and held to maturity (HTM) investments at December 31, 2012 and December 31, 2011 were as follows:

		Included in AOCI			
December 31, 2012 *(U.S. dollars in thousands)*	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses Related to Changes in Estimated Fair Value**	**Fair Value**	**N I C**
Fixed maturities AFS					
U.S. Government and Government-Related/Supported (2)	$ 1,906,044	$ 131,860	$ (3,287)	$ 2,034,617	$
Corporate (3)(4)(5)	9,837,962	723,028	(78,990)	10,482,000	
RMBS Agency	5,054,097	206,931	(5,535)	5,255,493	
RMBS Non-Agency	678,469	46,132	(76,868)	647,733	
CMBS	1,010,794	70,745	(4,288)	1,077,251	
CDO	784,999	11,973	(87,156)	709,816	
Other asset-backed securities (3)	1,426,483	59,663	(15,435)	1,470,711	
U.S. States and political subdivisions of the States	1,767,669	146,294	(2,946)	1,911,017	
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	4,078,289	188,186	(8,193)	4,258,282	
Total fixed maturities AFS	$ 26,544,806	$ 1,584,812	$ (282,698)	$ 27,846,920	$
Total short-term investments (2)	$ 322,563	$ 192	$ (52)	$ 322,703	$
Total equity securities	$ 617,486	$ 31,935	$ (62)	$ 649,359	$

Total investments AFS	$	27,484,855	$	1,616,939	$	(282,812)	$	28,818,982	$
Fixed maturities HTM									
U.S. Government and Government-Related/Supported (2)	$	10,788	$	1,651	$		$	12,439	$
Corporate (3)		1,425,320		190,871		(794)		1,615,397	
RMBS Non-Agency		83,205		10,502				93,707	
CMBS		12,751		2,048				14,799	
Other asset-backed securities (3)		222,340		29,287		(167)		251,460	
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)		1,060,043		216,679		(1,720)		1,275,002	
Total investments HTM	$	2,814,447	$	451,038	$	(2,681)	$	3,262,804	$

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

(1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

(2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of $1,912.7 million and fair value of $1,988.5 million and U.S. Agencies with an amortized cost of $404.3 million and fair value of $446.7 million.

(3) At December 31, 2012, Covered Bonds within Fixed maturities AFS with an amortized cost of $605.4 million and a fair value of $647.1 million and Covered Bonds within Fixed maturities HTM with an amortized cost of $8.4 million and a fair value of $8.6 million have been included within Other asset-backed securities to align the Company s classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.

(4)

Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of $194.3 million and an amortized cost of $194.8 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(5) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of $308.5 million and an amortized cost of $327.6 million at December 31, 2012.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

		Included in AOCI			
December 31, 2011 *(U.S. dollars in thousands)*	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses Related to Changes in Estimated Fair Value**	**Fair Value**	
Fixed maturities AFS					
U.S. Government and Government-Related/Supported (2)	$ 1,864,354	$ 130,874	$ (4,245)	$ 1,990,983	$
Corporate (3)(4)(5)	9,866,677	527,192	(285,247)	10,108,622	
RMBS Agency	5,189,473	193,782	(3,849)	5,379,406	
RMBS Non-Agency	851,557	19,667	(229,409)	641,815	
CMBS	927,684	56,704	(9,553)	974,835	
CDO	843,553	6,624	(191,575)	658,602	
Other asset-backed securities (3)	1,341,309	30,731	(31,791)	1,340,249	
U.S. States and political subdivisions of the States	1,698,573	101,025	(2,220)	1,797,378	
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	3,188,535	127,439	(17,839)	3,298,135	
Total fixed maturities AFS	$ 25,771,715	$ 1,194,038	$ (775,728)	$ 26,190,025	$
Total short-term investments (2)	$ 359,378	$ 519	$ (834)	$ 359,063	$
Total equity securities	$ 480,685	$ 27,947	$ (40,435)	$ 468,197	$
Total investments AFS	$ 26,611,778	$ 1,222,504	$ (816,997)	$ 27,017,285	$
Fixed maturities HTM					
U.S. Government and Government-Related/Supported (3)	$ 10,399	$ 1,510	$	$ 11,909	$

Corporate (3)		1,290,209		91,313		(14,433)		1,367,089	
RMBS Non-Agency		80,955		6,520		(32)		87,443	
Other asset-backed securities (3)		288,741		20,875		(320)		309,296	
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)		998,674		127,227		(5,950)		1,119,951	
Total investments HTM	$	2,668,978	$	247,445	$	(20,735)	$	2,895,688	$

(1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

(2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of $1,878.3 million and fair value of $1,915.6 million and U.S. Agencies with an amortized cost of $494.0 million and fair value of $541.2 million.

(3) Covered Bonds within Fixed maturities AFS with an amortized cost of $345.4 million and a fair value of $353.9 million and Covered Bonds within Fixed maturities HTM with an amortized cost of $8.1 million and a fair value of $7.7 million at December 31, 2011 have been reclassified from Corporate to Other asset-backed

securities to align the Company s classification to market indices and conform to current period presentation.

(4) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of $266.0 million and an amortized cost of $297.7 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(5) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of $386.1 million and an amortized cost of $494.9 million at December 31, 2011.

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

At December 31, 2012 and December 31, 2011, approximately 2.9% and 2.4%, respectively, of the Company s fixed income investment portfolio at carrying value was invested in securities that were below investment grade or not rated. Approximately 37.7% and 31.4% of the gross unrealized losses in the Company s fixed income securities portfolio at December 31, 2012 and December 31, 2011, respectively, related to securities that were below investment grade or not rated.

Classification of Fixed Income Securities

During the third quarter of 2011, the Company changed the manner in which it classifies fixed income securities between Fixed maturities and Short-term investments on the balance sheet and the related note disclosure. Short-term investments under the Company s previous classification comprised investments with a remaining maturity of less than one year from the reporting date. Under this prior presentation, longer term securities were reclassified from Fixed maturities to Short-term investments as they neared maturity. Under the Company s new classification, Short-term investments include investments due to mature within one year from the date of purchase and are valued using the same external factors and in the same manner as Fixed maturities. No reclassifications are made between Fixed maturities and Short-term investments subsequent to the initial date of purchase.

This change in classification did not have an impact on the total value of investments available for sale on the balance sheet, nor did it impact the consolidated statements of income, comprehensive income, shareholders equity or cash flows. The only impact, other than the changes in the balance sheet line items, are changes required within the detailed tables included within this note as well as Note 3, Fair Value Measurements, to allocate securities previously classified as Short-term investments under the former practice into the appropriate categories of Fixed maturities within each table to conform to the new accounting presentation for current and comparative periods.

Covered Bonds were included within Corporate securities prior to January 1, 2012. Beginning in 2012, they were classified as Other asset-backed securities to align the Company s classification to market indices. At December 31, 2011, Covered Bonds with a fair value of $353.9 million have been reclassified from Corporate to Other asset-backed securities to conform to current period presentation.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

Contractual Maturities Summary

The contractual maturities of AFS and HTM fixed income securities at December 31, 2012 and December 31, 2011 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31,2012 (1)		December 31,2011 (1)	
(U.S. dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Fixed maturities AFS				
Due less than one year	$ 1,939,803	$ 1,952,250	$ 2,004,395	$ 2,020,361
Due after 1 through 5 years	8,521,090	8,877,512	7,736,717	7,909,354
Due after 5 through 10 years	4,701,391	5,065,158	3,619,141	3,777,073
Due after 10 years	2,427,680	2,790,996	3,257,886	3,488,330
	$ 17,589,964	$ 18,685,916	$ 16,618,139	$ 17,195,118
RMBS Agency	5,054,097	5,255,493	5,189,473	5,379,406
RMBS Non-Agency	678,469	647,733	851,557	641,815
CMBS	1,010,794	1,077,251	927,684	974,835
CDO	784,999	709,816	843,553	658,602
Other asset-backed securities	1,426,483	1,470,711	1,341,309	1,340,249
Total mortgage and asset-backed securities	$ 8,954,842	$ 9,161,004	$ 9,153,576	$ 8,994,907
Total fixed maturities AFS	$ 26,544,806	$ 27,846,920	$ 25,771,715	$ 26,190,025
Fixed maturities HTM				
Due less than one year	$ 36,515	$ 37,580	$ 11,796	$ 11,768
Due after 1 through 5 years	195,121	205,562	122,091	123,871
Due after 5 through 10 years	377,541	420,008	393,865	402,424
Due after 10 years	1,886,974	2,239,688	1,771,530	1,960,886

	$	2,496,151	$	2,902,838	$	2,299,282	$	2,498,949
RMBS Non-Agency		83,205		93,707		80,955		87,443
CMBS		12,751		14,799				
Other asset-backed securities		222,340		251,460		288,741		309,296
Total mortgage and asset-backed securities	$	318,296	$	359,966	$	369,696	$	396,739
Total fixed maturities HTM	$	2,814,447	$	3,262,804	$	2,668,978	$	2,895,688

(1) Included in the table above are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions, at their fair value of $308.5 million and $386.1 million at December 31, 2012 and December 31, 2011, respectively. These securities are

reflected in the table based on their call date and have net unrealized losses of $19.1 million and $108.8 million at December 31, 2012 and December 31, 2011, respectively.

OTTI Considerations

Under final authoritative accounting guidance, a debt security for which amortized cost exceeds fair value is deemed to be other-than-temporarily impaired if it meets either of the following conditions: (a) the Company intends to sell, or it is more likely than not that the Company will be required to sell, the security before a recovery in value, or (b) the Company does not expect to recover the entire amortized cost basis of the security. Other than in a situation in which the Company has the intent to sell a debt security or more likely than not will be required to sell a debt security, the amount of the OTTI related to a credit loss on the security is recognized in earnings, and the amount of the OTTI related to other factors (e.g., interest rates, market conditions, etc.) is recorded as a component of OCI. The net amount recognized

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

in earnings (credit loss impairment) represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment (NPV). The remaining difference between the security s NPV and its fair value is recognized in OCI. Subsequent changes in the fair value of these securities are included in OCI unless a further impairment is deemed to have occurred.

In the scenario where the Company has the intent to sell a security in which its amortized cost exceeds its fair value, or it is more likely than not it will be required to sell such a security, the entire difference between the security s amortized cost and its fair value is recognized in earnings.

The determination of credit losses is based on detailed analyses of underlying cash flows. Such analyses require the use of certain assumptions to develop the estimated performance of underlying collateral. Key assumptions used include, but are not limited to, items such as RMBS default rates based on collateral duration in arrears, severity of losses on default by collateral class, collateral reinvestment rates and expected future general corporate default rates.

Factors considered for all securities on a quarterly basis in determining that a gross unrealized loss is not other-than-temporarily impaired include management s consideration of current and near term liquidity needs and other available sources of funds, an evaluation of the factors and time necessary for recovery and an assessment of whether the Company has the intention to sell or considers it more likely than not that it will be forced to sell a security.

Pledged Assets

Certain of the Company s invested assets are held in trust and pledged in support of insurance and reinsurance liabilities as well as credit facilities. Such pledges are largely required by the Company s operating subsidiaries that are non-admitted under U.S. state insurance regulations, in order for the U.S. cedant to receive statutory credit for reinsurance. Also, certain deposit liabilities and annuity contracts require the use of pledged assets. At December 31, 2012 and December 31, 2011, the Company had $16.9 billion and $17.2 billion in pledged assets, respectively.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments (Continued)

(b) Gross Unrealized Losses

The following is an analysis of how long the AFS and HTM securities at December 31, 2012 and December 31, 2011 had been in a continual unrealized loss position:

	Less than 12 months		Equal to or greater than 12 months	
December 31, 2012 *(U.S. dollars in thousands)*	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Fixed maturities and short-term investments AFS				
U.S. Government and Government-Related/Supported	$ 307,879	$ (2,847)	$ 9,951	$ (471)
Corporate (1)(2)(3)	476,454	(10,603)	607,796	(68,387)
RMBS Agency	578,823	(4,541)	11,135	(994)
RMBS Non-Agency	6,674	(450)	448,555	(76,418)
CMBS	92,899	(666)	23,580	(3,622)
CDO	243	(1)	694,351	(87,155)
Other asset-backed securities (3)	111,431	(531)	93,388	(14,904)
U.S. States and political subdivisions of the States	77,273	(1,407)	12,851	(1,539)
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	355,409	(1,378)	131,884	(6,836)
Total fixed maturities and short-term investments AFS	$ 2,007,085	$ (22,424)	$ 2,033,491	$ (260,326)
Total equity securities (4)	$ 615	$ (62)	$	$
Fixed maturities HTM				
Corporate (3)	$ 4,568	$ (31)	$ 23,005	$ (763)
Other asset-backed securities (3)	1,239	(167)		
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported			10,518	(1,720)

Total fixed maturities	**HTM**	$	5,807	$	(198)	$	33,523	$	(2,483)

(1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, have a fair value of $194.3 million and an amortized cost of $194.8 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the

ultimate values of these notes.

(2) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities, which are in a gross unrealized loss position, have a fair value of $308.5 million and an amortized cost of $327.6 million at December 31, 2012.

(3) Covered Bonds within Fixed maturities and short-term investments AFS with a fair value of $647.1 million and

Covered Bonds within Fixed Maturities HTM with a fair value of $8.6 million have been included within Other asset-backed securities to align the Company s classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.

(4) Included within equity securities are investments in fixed income funds with a fair value of $101.9 million and an amortized cost of $100.0 million at December 31, 2012.

XL GROUP PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

5. Investments (Continued)

(b) Gross Unrealized Losses (Continued)

December 31, 2011 *(U.S. dollars in thousands)*	**Less than 12 months**	**Equal to or greater than 12 months**
	Fair Value	