XL CAPITAL LTD
Form 10-Q/A
November 09, 2006

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

FORM 10-Q/A
(Amendment No. 1)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

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 CAPITAL LTD
(Exact name of registrant as specified in its charter)

CAYMAN ISLANDS	98-0191089
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

XL House, One Bermudiana Road, Hamilton, Bermuda HM 11
(Address of principal executive offices and zip code)
(441) 292-8515
(Registrant's telephone number, including area code)

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 [X] No [ ]

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. (Check one): Large accelerated filer |X| Accelerated filer _____ Non-accelerated filer _____

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

As of August 2, 2006, there were 180,409,046 outstanding Class A Ordinary Shares, $0.01 par value per share, of the registrant.

XL CAPITAL LTD

INDEX TO FORM 10-Q

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (this Amendment) amends the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 filed on August 9, 2006 (the Original Filing). XL Capital Ltd has filed this Amendment to correct certain errors in the Unaudited Consolidated Statements of Cash Flows as described in Note 11, Retatement of Consolidated Statements of Cash Flows, as well as to make corresponding textual changes in Item 2, Managements Discussion and Analysis of Financial Condition and Results of Operations and to add related information in Item 4, Controls and Procedures. Other information contained herein has not been updated. Therefore, you should read this Amendment together with other documents and reports that we have filed with the Securities and Exchange Commission subsequent to the filing of the Original Filing. Information in such documents and reports updates and supersedes certain information contained in this Amendment. More current information with respect to XL Capital Ltd. is contained within its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, and other filings with the Securities and Exchange Commission.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share amounts)

	(Unaudited) June 30, 2006	December 31, 2005
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2006, $33,247,738; 2005, $31,984,076)	$ 32,792,886	$ 32,309,565
Equity securities, at fair value (cost: 2006, $707,118; 2005, $696,858)	838,364	868,801
Short-term investments, at fair value (amortized cost: 2006, $2,776,907; 2005, $2,552,589)	2,772,074	2,546,073
Total investments available for sale	36,403,324	35,724,439
Investments in affiliates	2,021,256	2,046,721
Other investments	442,797	399,417
Total investments	38,867,377	38,170,577
Cash and cash equivalents	2,566,768	3,693,475
Accrued investment income	398,552	391,660
Deferred acquisition costs.	972,655	866,200
Prepaid reinsurance premiums	1,260,633	1,067,556
Premiums receivable	4,432,477	3,799,041
Reinsurance balances receivable	1,026,890	1,043,013
Unpaid losses and loss expenses recoverable	6,148,443	6,441,522
Goodwill and other intangible assets	1,817,503	1,814,544
Deferred tax asset, net	344,527	318,399
Other assets	691,528	848,914
Total assets	$ 58,527,353	$ 58,454,901
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 23,733,500	$ 23,767,672
Deposit liabilities	7,559,896	8,240,987
Future policy benefit reserves	6,069,691	5,606,461
Unearned premiums	6,372,442	5,388,996
Notes payable and debt	3,367,887	3,412,698
Reinsurance balances payable	1,038,022	1,414,752
Net payable for investments purchased	450,548	639,034
Other liabilities	1,331,236	1,438,234
Minority interest	56,847	74,256

Total liabilities	$ 49,980,069	$ 49,983,090

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share amounts)

	(Unaudited) June 30, 2006	December 31, 2005
Commitments and Contingencies		
Shareholders Equity:		
Series A preference ordinary shares, 9,200,000 authorized,		
par value $0.01 Issued and outstanding: 2006 and 2005, 9,200,000	$ 92	$ 92
Series B preference ordinary shares, 11,500,000 authorized, par value $0.01 Issued and outstanding: 2006 and 2005, 11,500,000	115	115
Series C preference ordinary shares, 20,000,000 authorized,		
par value $0.01 Issued and outstanding 2006 and 2005, nil		
Class A ordinary shares, 999,990,000 authorized, par value $0.01		
Issued and outstanding: 2006, 180,394,236; 2005, 179,528,593	1,804	1,795
Additional paid in capital	6,426,468	6,472,839
Accumulated other comprehensive (loss) income	(403,842)	268,243
Deferred compensation		(95,464)
Retained earnings	2,522,647	1,824,191
Total shareholders equity	$ 8,547,284	$ 8,471,811
Total liabilities and shareholders equity	$ 58,527,353	$ 58,454,901

See accompanying Notes to Unaudited Consolidated Financial Statements

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XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF INCOME
(U.S. dollars in thousands, except per share amounts)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Revenues:				
Net premiums earned	$ 1,984,590	$ 3,712,768	$ 3,803,139	$ 5,612,203
Net investment income	473,622	367,401	937,364	675,606
Net realized (losses) gains on investments	(23,604)	90,055	(839)	150,726
Net realized and unrealized gains (losses) on derivative instruments	29,238	(47,941)	78,089	(2,763)
Net income (loss) from investment affiliates	28,849	(10,774)	135,242	59,738
Fee income and other	6,630	(3,048)	19,592	14,112
Total revenues	$ 2,499,325	$ 4,108,461	$ 4,972,587	$ 6,509,622
Expenses:				
Net losses and loss expenses incurred	$ 1,119,561	$ 1,261,707	$ 2,216,685	$ 2,404,768
Claims and policy benefits	232,453	2,020,664	375,333	2,146,291
Acquisition costs	295,512	310,988	562,599	605,382
Operating expenses	279,464	248,950	541,025	496,106
Exchange losses (gains)	22,693	(10,693)	53,442	229
Interest expense	134,632	97,766	262,501	186,052
Amortization of intangible assets	420	3,043	1,515	5,836
Total expenses	$ 2,084,735	$ 3,932,425	$ 4,013,100	$ 5,844,664
Income before minority interest, income tax and equity in net (income) of insurance and financial affiliates	$ 414,590	$ 176,036	$ 959,487	$ 664,958
Minority interest in net income of subsidiary	—	2,079	2,258	4,354
Income tax	66,437	41,776	133,073	94,650
Net (income) from operating affiliates	(39,016)	(13,794)	(31,596)	(33,046)
Net income	387,169	145,975	855,752	599,000
Preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)

Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares and ordinary share equivalents outstanding basic	178,728	138,948	179,631	138,488
Weighted average ordinary shares and ordinary share equivalents outstanding diluted	179,198	140,404	180,069	139,841
Earnings per ordinary share and ordinary share equivalent basic	$ 2.11	$ 0.98	$ 4.65	$ 4.18
Earnings per ordinary share and ordinary share equivalent diluted	$ 2.10	$ 0.97	$ 4.64	$ 4.14

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(U.S. dollars in thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Change in net unrealized (depreciation) appreciation of investments, net of tax	(357,247)	388,243	(756,485)	44,103
Amortization of derivative loss on cash flow hedge	157	157	312	313
Foreign currency translation adjustments, net	85,762	61,252	96,998	79,322
Net unrealized (loss) gain on future policy benefit reserves	(10,401)	2,508	(12,910)	5,590
Comprehensive income	$ 105,440	$ 598,135	$ 183,667	$ 728,328

See accompanying Notes to Unaudited Consolidated Financial Statements

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XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30, 2006	(Unaudited) Six Months Ended June 30, 2005
Series A and B Preference Ordinary Shares:		
Balance beginning of year	$ 207	$ 207
Issue of shares		
Balance end of period	$ 207	$ 207
Class A Ordinary Shares:		
Balance beginning of year	$ 1,795	$ 1,389
Issue of shares	8	8
Exercise of stock options	2	8
Repurchase of shares	(1)	(1)
Balance end of period	$ 1,804	$ 1,404
Additional Paid in Capital:		
Balance beginning of year	$ 6,472,839	$ 3,950,175
Issue of shares	51,122	60,306
Repurchase of ordinary shares	(2,199)	(1,630)
Stock option expense	11,856	9,685
Exercise of stock options	8,422	34,515
Equity reclassification impact of adopting FAS 123(r)	(95,464)	
Net change in deferred compensation	(20,108)	
Balance end of period	$ 6,426,468	$ 4,053,051
Accumulated Other Comprehensive Income:		
Balance beginning of year	$ 268,243	$ 460,273
Net change in unrealized gains (losses) on investment portfolio, net of tax	(774,908)	41,125
Net change in unrealized gains (losses) on investment portfolio of affiliates	18,423	2,978
Amortization of derivative loss on cash flow hedge	312	313
Net unrealized gains (losses) on future policy benefit reserves	(12,910)	5,590
Currency translation adjustments	96,998	79,322
Balance end of period	$ (403,842)	$ 589,601
Deferred Compensation:		
Balance beginning of year	$ (95,464)	$ (69,988)
Issue of restricted shares		(57,604)
Amortization		20,477

Equity reclassification impact of adopting FAS 123(r)	95,464	
Balance end of period	$	$ (107,115)
Retained Earnings:		
Balance beginning of year	$ 1,824,191	$ 3,396,639
Net income	855,752	599,000
Dividends on Series A and B preference ordinary shares	(20,160)	(20,160)
Dividends on Class A ordinary shares	(134,885)	(138,186)
Repurchase of ordinary shares	(2,251)	(2,765)
Balance end of period	$ 2,522,647	$ 3,834,528
Total Shareholders Equity	$ 8,547,284	$ 8,371,676

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2006 (as restated)	**2005 (as restated)**
Cash flows provided by operating activities:		
Net income	$ 855,752	$ 599,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized losses (gains) on investments	839	(150,726)
Net realized and unrealized (gains) losses on derivative instruments	(78,089)	2,763
Amortization of (discounts) premiums on fixed maturities	(1,206)	30,380
Equity in net income from investment, insurance and financial affiliates	(166,838)	(92,784)
Amortization of deferred compensation	30,004	20,477
Accretion of convertible debt	481	485
Accretion of deposit liabilities	160,203	105,219
Unpaid losses and loss expenses	(440,853)	518,186
Future policy benefit reserves	59,806	1,806,417
Unearned premiums	888,142	985,440
Premiums receivable.	(543,051)	(761,279)
Unpaid losses and loss expenses recoverable	415,205	311,612
Prepaid reinsurance premiums	(177,704)	(130,415)
Reinsurance balances receivable	40,543	66,666
Deferred acquisition costs	(89,499)	(121,351)
Reinsurance balances payable	(380,239)	(43,852)
Deferred tax asset	1,990	75,411
Other assets	197,670	(160,757)
Other	(11,017)	145,873
Total adjustments	$ (93,613)	$ 2,607,765
Net cash provided by operating activities	$ 762,139	$ 3,206,765
Cash flows used in investing activities:		
Proceeds from sale of fixed maturities and short-term investments	$ 11,074,558	$ 10,900,166
Proceeds from redemption of fixed maturities and short-term investments	650,275	647,275
Proceeds from sale of equity securities	789,977	603,350
Purchases of fixed maturities and short-term investments	(12,778,203)	(15,688,895)
Purchases of equity securities	(723,646)	(556,562)
Investments in affiliates, net of dividends received	186,969	2,252

Acquisition of subsidiaries, net of cash acquired	(12,600)	—
Other investments	(39,155)	24,240
Other assets	4,097	—
Net cash used in investing activities	$ (847,728)	$ (4,068,174)
Cash flows provided by financing activities:		
Proceeds from exercise of stock options and issuance of common shares	7,941	40,446
Repurchase of shares	(4,451)	(4,396)
Dividends paid	(155,045)	(158,348)
Repayment of loans	(45,291)	—
Deposit liabilities	(786,898)	1,260,109
Net cash flow on securities lending	(81,112)	(71,834)
Net cash (used in) provided by financing activities	(1,064,856)	1,065,977
Effects of exchange rate changes on foreign currency cash	23,738	(32,954)
(Decrease) increase in cash and cash equivalents	(1,126,707)	171,614
Cash and cash equivalents — beginning of period	3,693,475	2,203,726
Cash and cash equivalents — end of period	$ 2,566,768	$ 2,375,340

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

These unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America. (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, these unaudited financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and results of operations as at the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All significant inter-company accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts 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. Actual results could differ materially from these estimates.

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. There was no effect on net income from this change in presentation.

Unless the context otherwise indicates, references herein to the Company include XL Capital Ltd and its consolidated subsidiaries.

2. Significant Accounting Policies

(a) Stock-Based compensation

Effective January 1, 2003, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (FAS) No. 123, *Accounting for Stock-Based Compensation* (FAS 123), as amended by FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (FAS 148), 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 FAS 123 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 Companys ordinary shares on the date of the grant. At June 30, 2006, the Company had several stock based Performance Incentive Programs, which are described more fully in Note 19 to the consolidated financial statements filed on Form 10-K/A for the year ended December 31, 2005. Stock-based compensation issued under these plans generally have a life of not longer than ten years and vest as set forth at the time of grant. Options currently vest annually over three or four years from the date of grant.

In 2004, the FASB issued SFAS No.123 (revised 2004) (FAS 123(r)), Share-Based Payment, which is a revision of SFAS 123. SFAS 123(r) superseded FAS 123, APB 25 and amended SFAS 95, Statement of Cash Flows. Generally, the approach to accounting for share-based payments in FAS 123(r) is similar to the approach described in FAS 123, which the Company adopted on a prospective basis in 2003. However, FAS 123(r) requires all share-based payments to employees, including grants of employee stock options (for all grant years), to be recognized in the financial statements over the vesting period based on their grant date fair values.

The Company adopted FAS 123(r) effective January 1, 2006 using the modified-prospective method to account for share-based payments made to employees. The modified-prospective method is similar to the modified-prospective method described in SFAS 148. Under this method, compensation cost is recognized beginning with the effective date (a) based on the requirements of FAS 123(r) for all share-based payments granted after the effective date and (b) based on the requirements of FAS 123(r) for all awards granted to employees prior to the effective date of FAS 123(r) that remain unvested on the effective date.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

2. Significant Accounting Policies (continued)

	Three and Six Months Ended June 30, 2006	Three and Six Months Ended June 30, 2005
Dividend yield	2.1%	2.6%
Risk free interest rate	4.7%	4.0%
Expected volatility	25.0%	25.0%
Expected lives	5.5 years	5.5 years

In the first six months of 2006 and 2005, the Company granted 182,800 and 1,877,500 options, respectively, to purchase its ordinary shares to directors and employees related to incentive compensation plans, with a weighted average grant-date fair value of $17.33 and $17.04, respectively. During the three-month periods ended June 30, 2006 and 2005, the Company recognized $5.7 million and $5.5 million, respectively, of compensation expense, net of tax, related to its stock option plans. During the six-month periods ended June 30, 2006 and 2005, the Company recognized $10.4 million and $9.7 million, respectively, of compensation expense, net of tax, related to its stock option plan. Total intrinsic value of stock options exercised during the six-month periods ended June 30, 2006 and 2005 was $2.7 million and $14.8 million, respectively.

The following is a summary of stock options as of June 30, 2006, and related activity for the six months ended June 30, 2006:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (000s)
Outstanding beginning of period	12,745,290	75.35	6.0 years	
Granted	182,800	67.58		
Exercised	(163,657)	49.92		
Cancelled	(380,892)	78.32		
Outstanding end of period	12,383,541	75.48	5.4 years	$19,480
Options exercisable	9,888,823		4.8 years	$19,480
Options available for grant*	12,850,862			

* Available for grant includes shares that may be granted as either stock options or restricted stock.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between XL's closing stock price on the last trading day of the second quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money-options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. Total unrecognized stock based compensation expense related to non-vested stock options was approximately $39.1 million as of the end of June 30, 2006, related to approximately 12.4 million options, which is expected to be recognized over a weighted-average period of 1.6 years.

In the first six-months of 2006, the Company incurred no additional stock based compensation due to the adoption of FAS 123(r) related to the vesting in 2006 of options granted prior to January 1, 2003, as all options granted prior to that date had been fully vested by June 30, 2006.

For all periods presented prior to 2006, and for all options granted prior to January 1, 2003, the Company accounted for stock option grants under the recognition and measurement principles of APB 25 and related interpretations and accordingly, recognized no compensation expense for these stock options granted to employees. The following table

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Significant Accounting Policies (continued)

illustrates the effect on earnings per share for the three-month and six-month periods ended June 30, 2005, if the Company had applied the fair value recognition provisions of SFAS 123 to all of its stock-based employee compensation:

(U.S. dollars in thousands, except per share amounts)	(Unaudited) Three Months Ended June 30, 2005	(Unaudited) Six Months Ended June 30, 2005
Net income available to ordinary shareholders as reported	$ 135,895	$ 578,840
Add: Stock based employee compensation expense included in reported net income, net of related tax	5,508	9,685
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(6,189)	(14,318)
Pro forma net income available to ordinary shareholders	$ 135,214	574,207
Earnings per share:		
Basic as reported	$0.98	$4.18
Basic pro forma	$0.97	$4.15
Diluted as reported	$0.97	$4.14
Diluted pro forma	$0.96	$4.11

Restricted stock awards issued under the 1991 Performance Incentive Program vest as set forth in the applicable award agreements. These shares contained certain restrictions prior to vesting, relating to, among other things, forfeiture in the event of termination of employment and transferability.

In first six months of 2006 and 2005, the Company granted 758,362 and 864,686 shares, respectively, of its restricted common stock to its directors and employees related to incentive compensation plans, with a weighted average grant date fair value per share of $66.59 and $75.47, respectively. During the three-month periods ended June 30, 2006 and 2005, $11.0 million and $11.3 million, respectively, was charged to compensation expense related to restricted stock awards. During the six-month periods ended June 30, 2006 and 2005, $30.0 million and $20.5 million, respectively, was charged to compensation expense related to restricted stock awards. Total unrecognized stock based compensation expense related to non-vested restricted stock awards was approximately $115.6 million as of the end of June 30, 2006, related to approximately 1.9 million restricted stock awards, which is expected to be recognized over 2.8 years. Non-vested restricted stock awards as of June 30, 2006 and for the six months then ended were as follows:

	Number of shares (thousands)	Weighted-Average Grant Date Fair Value
Unvested at December 31, 2005	1,529	$62.43
Granted	758	$66.59
Vested	(333)	$74.91

Forfeited	(89)	$73.97
Unvested at June 30, 2006	1,865	$72.06

FAS 123(r) 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 has adopted this 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 options granted. In the first six months of 2006, the Company incurred $6.4 million of additional stock based compensation expense due to the adoption of FAS 123(r) related to this treatment of retirement eligible employees as compared to the previous attribution methodology.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Recent Accounting Pronouncements

In February 2006, the FASB issued FAS 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140*. This standard permits fair value re-measurement of an entire hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; narrows the scope exemption applicable to interest-only strips and principal-only strips from FAS 133, clarifies that only the simplest separations of interest payments and principal payments qualify as not being subject to the requirements of FAS 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends FAS140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is intended to require more consistent accounting that eliminates exemptions and provides a means to simplify the accounting for hybrid financial instruments. This statement is effective for all financial instruments acquired or issued after January 1, 2007 and is not expected to have a material impact on the Companys financial condition or results of operations. As at June 30, 2006 the Company has not elected to apply the fair value option for any hybrid financial instruments.

In April 2006, the FASB issued FSP FIN 46(R)-6, *Determining the Variability to be Considered in Applying FIN 46(R)*, which states that the variability to be considered when applying FIN 46(R) should be based on an analysis of the design of an entity, which entails analyzing the nature of the risks in the entity, determining the purpose for which the entity was created and determining the variability the entity is designed to create and pass along to its interest holders. Typically, assets and operations of the entity create the variability (and thus are not variable interests), while liabilities and equity interests absorb that variability (and thus, are variable interests). The role of a contract or arrangement in the design of the entity, regardless of its legal form or accounting classification, shall dictate whether that interest should be treated as creating or absorbing variability for the entity. The guidance in this FSP must be applied as of July 1, 2006, and is not expected to have a material impact on the Companys financial condition or results of operations but will form an important part of the Companys evaluation of any relevant structures going forward.

In June 2006, the FASB issued proposed FSP FAS 123(R)-e, *Amendment of FASB Staff Position FAS 123(R)-1*, which addresses whether the modification of an instrument in connection with an equity restructuring or a business combination should be considered a modification for purposes of applying FSP FAS 123(R)-1, *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)*. The FASB staff has taken the position that for instruments that were originally issued as employee compensation and then exchanged or changed, where the only change is a change to the terms of an award to reflect an equity restructuring or a business combination that occurs when the holders are no longer employees, then no change in the recognition and measurement (due to a change in classification) of these instruments will result if, there is (i) no increase in value to the holders of the instrument or (ii) the exchange or change in the terms of the award is not made in contemplation of an equity restructuring or a business combination and (iii) all holders of the same class of equity instruments (for example, stock options) are treated in a similar manner. These provisions must be applied in the first reporting period beginning after the date the final FSP is posted to the FASBs website. This guidance is not expected to have a significant impact on the Companys financial condition or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprises financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The evaluation of a tax position in accordance with this guidance is a two-step process. The first step is recognition where the Company determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Recent Accounting Pronouncements (continued)

processes, based on the technical merits of the position. The second step is measurement where a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. FIN 48 requires qualitative and quantitative disclosures, including discussion of reasonably possible changes that might occur in the recognized tax benefits over the next 12 months; a description of open tax years by major jurisdictions; and a roll-forward of all unrecognized tax benefits, presented as a reconciliation of the beginning and ending balances of the unrecognized tax benefits on a worldwide aggregated basis. The provisions of FIN 48 must be applied beginning January 1, 2007. The Company is currently evaluating the impact of this guidance on the Company's financial condition and results of operations.

4. Segment Information

The Company is organized into four operating segments — Insurance, General Reinsurance, Life and Annuity Reinsurance and Financial Products and Services — in addition to a Corporate segment that includes the general investment and financing operations of the Company. Following changes in executive management responsibilities in 2006, the Company now considers the Life and Annuity Reinsurance business as a separate operating segment. General operations include property and casualty lines of business.

The Company evaluates the performance of each segment based on underwriting results for general operations, net income from life and annuity operations and contribution from financial operations. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate assets by segment for its general operations. Investment assets related to the Company's life and annuity and financial operations are held in separately identified portfolios. Net investment income from these assets is included in net income from life and annuity operations and contribution from financial operations, respectively.

Following changes in certain executive management responsibilities in January 2005, the Company changed the reporting segments under which certain business units are reported in order to reflect these changes in responsibilities.

- Results of business structured by XL Financial Solutions Ltd ("XLFS") are now included entirely within the Financial Products and Services segment whereas previously this unit was reported in all three segments, depending on the nature of individual contracts.
- Certain blocks of U.S.-based term life mortality reinsurance business previously included in the Financial Products and Services segment are now included in the Reinsurance segment as management of these contracts was transferred to the life reinsurance business units in order to centralize the Company's management of traditional mortality-based reinsurance business.
- Political risk insurance business units now report to executive management of the Financial Products and Services segment and, as such, earnings from this business are no longer reported in the Insurance segment but included with financial operations.
- All operations of business units within the Financial Products and Services segment, including municipal reinvestment contracts and funding agreements, are now reported under financial operations in order to consolidate businesses with similar operating characteristics and risks.
- Net investment income and net income from affiliates generated by assets and interest expense incurred on liabilities of the business units within the Financial Products and Services segment is reported under

financial operations. This income and expense is included in financial operations as it relates to interest on portfolios of separately identified and managed assets and deposit liabilities.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 1,029,135	$ 671,871	$ —	$ 1,701,006
Fee income and other	7,099	(2,109)	—	4,990
Net losses and loss expenses	681,728	372,613	—	1,054,341
Acquisition costs	113,555	159,485	—	273,040
Operating expenses (1)	157,604	45,077	—	202,681
Exchange (gains) losses	46,324	(21,083)	—	25,241
Underwriting profit	$ 37,023	$ 113,670	$ —	$ 150,693
Life and Annuity Operations:				
Life premiums earned	$ —	$ 179,894	$ —	$ 179,894
Fee income and other	—	128	—	128
Claims and policy benefits	—	232,453	—	232,453
Acquisition costs	—	12,279	—	12,279
Operating expenses (1)	—	5,446	—	5,446
Exchange losses (gains)	—	(2,864)	—	(2,864)
Net investment income	—	85,371	—	85,371
Interest expense	—	—	—	—
Net income from life and annuity operations	$ —	$ 18,079	$ —	$ 18,079
Financial Operations:				
Net premiums earned			$ 103,690	$ 103,690
Fee income and other			1,512	1,512
Net losses and loss expenses			65,220	65,220
Acquisition costs			10,193	10,193
Operating expenses (1)			20,399	20,399
Exchange losses			316	316
Underwriting profit			$ 9,074	$ 9,074
Net investment income — financial guarantee			$ 18,323	$ 18,323
Net investment income — structured products			108,487	108,487

Interest expense — structured products	80,521	80,521
Operating expenses — structured products (1)	11,625	11,625
Net income from financial and investment affiliates	12,255	12,255
Minority interest	—	—
Net results from derivatives (2)	3,887	3,887
Contribution from financial operations	$ 59,880	$ 59,880

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2006 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 261,441
Net realized and unrealized gains on investments and derivative instruments (3)				1,747
Net income from investment and operating affiliates				55,610
Interest expense (4)				54,111
Amortization of intangible assets				420
Corporate operating expenses				39,313
Income tax				66,437
Net Income				$ 387,169
General Operations:				
Loss and loss expense ratio (5)	66.2%	55.5%		62.0%
Underwriting expense ratio (5)	26.4%	30.4%		28.0%
Combined ratio (5)	92.6%	85.9%		90.0%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized gains on credit derivatives of $2.7 million, and weather and energy derivatives of $1.9 million and losses on structured financial derivatives of $0.7 million.

(3) This includes net realized losses on investments of $23.6 million and net realized and unrealized gains on investment derivatives of $25.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 1,054,360	$ 673,201	$ —	$ 1,727,561
Fee (loss) income and other	(2,916)	(463)	—	(3,379)
Net losses and loss expenses	676,374	568,154	—	1,244,528
Acquisition costs	119,032	149,049	—	268,081
Operating expenses (1)	140,261	38,153	—	178,414
Exchange (gains) losses	(34,104)	21,895	—	(12,209)
Underwriting profit (loss)	$ 149,881	$ (104,513)	$ —	$ 45,368
Life and Annuity Operations:				
Life premiums earned	$ —	$ 1,933,215	$ —	$ 1,933,215
Fee income and other	—	114	—	114
Claims and policy benefits	—	2,020,664	—	2,020,664
Acquisition costs	—	35,058	—	35,058
Operating expenses (1)	—	5,068	—	5,068
Exchange losses	—	403	—	403
Net investment income	—	71,963	—	71,963
Interest expense	—	—	—	—
Net loss from life and annuity operations	$ —	$ (55,901)	$ —	$ (55,901)
Financial Operations:				
Net premiums earned			$ 51,992	$ 51,992
Fee income and other			217	217
Net losses and loss expenses			17,179	17,179
Acquisition costs			7,849	7,849
Operating expenses (1)			17,338	17,338
Exchange losses			1,113	1,113
Underwriting profit			$ 8,730	$ 8,730
Net investment income — financial guarantee			$ 14,986	$ 14,986
Net investment income — structured products			70,725	70,725

Interest expense structured products	54,134	54,134
Operating expenses structured products (1)	13,439	13,439
Net loss from financial and investment affiliates	(7,437)	(7,437)
Minority interest	2,300	2,300
Net results from derivatives (2)	17,487	17,487
Contribution from financial operations	$ 34,618	$ 34,618

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2005 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 209,727
Net realized and unrealized gains on investments and derivative instruments (3)				24,627
Net income from investment and operating affiliates				10,457
Interest expense (4)				43,632
Amortization of intangible assets				3,043
Corporate operating expenses				34,691
Minority interest				(221)
Income tax				41,776
Net Income				$ 145,975
General Operations:				
Loss and loss expense ratio (5)	64.2%	84.4%		72.0%
Underwriting expense ratio (5)	24.5%	27.8%		25.9%
Combined ratio (5)	88.7%	112.2%		97.9%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized losses on credit derivatives of $4.0 million, and gains on weather and energy derivatives of $4.1 million and structured financial derivatives of $17.4 million.

(3) This includes net realized gains on investments of $90.1 million and net realized and unrealized losses on investment derivatives of $65.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 2,060,432	$ 1,306,998	$ —	$ 3,367,430
Fee income and other	14,494	817	—	15,311
Net losses and loss expenses	1,359,235	759,701	—	2,118,936
Acquisition costs	241,249	282,524	—	523,773
Operating expenses (1)	295,682	84,653	—	380,335
Exchange losses (gains)	77,035	(17,669)	—	59,366
Underwriting profit	$ 101,725	$ 198,606	$ —	$ 300,331
Life and Annuity Operations:				
Life premiums earned	$ —	$ 270,559	$ —	$ 270,559
Fee income and other	—	194	—	194
Claims and policy benefits	—	375,333	—	375,333
Acquisition costs	—	21,554	—	21,554
Operating expenses (1)	—	11,924	—	11,924
Exchange losses (gains)	—	(6,238)	—	(6,238)
Net investment income	—	163,994	—	163,994
Net income from life and annuity operations	$ —	$ 32,174	$ —	$ 32,174
Financial Operations:				
Net premiums earned			$ 165,150	$ 165,150
Fee income and other			4,087	4,087
Net losses and loss expenses			97,749	97,749
Acquisition costs			17,272	17,272
Operating expenses (1)			38,682	38,682
Exchange losses			314	314
Underwriting profit			$ 15,220	$ 15,220
Net investment income — financial guarantee			$ 35,400	$ 35,400
Net investment income — structured products			214,162	214,162
Interest expense — structured products			158,040	158,040

Operating expenses structured products (1)	21,629	21,629
Net income from financial and investment affiliates	18,704	18,704
Minority interest	2,258	2,258
Net results from structured derivatives (2)	22,815	22,815
Contribution from financial operations	$ 124,374	$ 124,374

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2006 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 523,808
Net realized and unrealized gains on investments and derivative instruments (3)				54,435
Net income from investment and operating affiliates				148,134
Interest expense (4)				104,461
Amortization of intangible assets				1,515
Corporate operating expenses				88,455
Income tax				133,073
Net Income				$ 855,752
General Operations:				
Loss and loss expense ratio (5)	66.0%	58.1%		62.9%
Underwriting expense ratio (5)	26.0%	28.1%		26.9%
Combined ratio (5)	92.0%	86.2%		89.8%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized gains on credit derivatives of $1.4 million, weather and energy derivatives of $22.9 million and losses on structured financial derivatives of $1.5 million.

(3) This includes net realized losses on investments of $0.8 million, net realized and unrealized gains on investment derivatives of $55.2 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 2,136,878	$ 1,356,952	$ —	$ 3,493,830
Fee income (loss) and other	1,011	(446)	—	565
Net losses and loss expenses	1,401,889	978,504	—	2,380,393
Acquisition costs	257,775	291,239	—	549,014
Operating expenses (1)	266,129	79,559	—	345,688
Exchange (gains) losses	(19,789)	18,281	—	(1,508)
Underwriting profit (loss)	$ 231,885	$ (11,077)	$ —	$ 220,808
Life and Annuity Operations:				
Life premiums earned	$ —	$ 2,014,686	$ —	$ 2,014,686
Fee income and other	—	179	—	179
Claims and policy benefits	—	2,146,291	—	2,146,291
Acquisition costs	—	41,409	—	41,409
Operating expenses (1)	—	9,251	—	9,251
Exchange losses	—	673	—	673
Net investment income	—	131,866	—	131,866
Net loss from life and annuity operations	$ —	$ (50,893)	$ —	$ (50,893)
Financial Operations:				
Net premiums earned			$ 103,687	$ 103,687
Fee income and other			13,368	13,368
Net losses and loss expenses			24,375	24,375
Acquisition costs			14,959	14,959
Operating expenses (1)			34,894	34,894
Exchange losses			1,064	1,064
Underwriting profit			$ 41,763	$ 41,763
Net investment income — financial guarantee			$ 29,504	$ 29,504
Net investment income — structured products			132,579	132,579
			96,544	96,544

Interest expense structured products		
Operating expenses structured products (1)	23,197	23,197
Net loss from financial and investment affiliates	(809)	(809)
Minority interest	4,575	4,575
Net results from derivatives (2)	33,565	33,565
Contribution from financial operations	$ 112,286	$ 112,286

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2005 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 381,657
Net realized and unrealized gains on investments and derivative instruments (3)				114,398
Net income from investment and operating affiliates				93,593
Interest expense (4)				89,508
Amortization of intangible assets				5,836
Corporate operating expenses				83,076
Minority interest				(221)
Income tax				94,650
Net Income				$ 599,000
General Operations:				
Loss and loss expense ratio (5)	65.6%	72.1%		68.1%
Underwriting expense ratio (5)	24.5%	27.3%		25.6%
Combined ratio (5)	90.1%	99.4%		93.7%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized gains on credit derivatives of $6.2 million, weather and energy derivatives of $10.2 million and structured financial derivatives of $17.2 million.

(3) This includes net realized gains on investments of $150.7 million and net realized and unrealized losses on investment derivatives of $36.3 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

The following tables summarize the Company’s net premiums earned by line of business:

Three months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 435,284	$ 96,088	$ —
Casualty	242,748	199,212	—
Property catastrophe	28,748	68,758	—
Other property	160,707	167,699	—
Marine, energy, aviation and satellite	130,395	38,601	—
Other (1)	31,253	101,513	—
Total general operations	$ 1,029,135	$ 671,871	$ —
Life and annuity operations	—	179,894	—
Financial operations	—	—	103,690
Total	$ 1,029,135	$ 851,765	$ 103,690

(1) Other, includes bonding, warranty, accident and health and other lines of business.

Three months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 348,743	$ 90,755	$ —
Casualty	275,811	226,405	—
Property catastrophe	23,300	70,273	—
Other property	149,308	149,588	—
Marine, energy, aviation and satellite	184,747	43,997	—
Other (1)	72,451	92,183	—
Total general operations	$ 1,054,360	$ 673,201	$ —

Life and annuity operations	—	1,933,215	—
Financial operations	—	—	51,992
Total	$ 1,054,360	$ 2,606,416	$ 51,992

(1) Other, includes bonding, warranty, accident and health and other lines of business.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 802,578	$ 178,456	$ —
Casualty	484,002	377,546	—
Property catastrophe	48,211	122,802	—
Other property	336,055	352,155	—
Marine, energy, aviation and satellite	303,037	74,031	—
Other (1)	86,549	202,008	—
Total general operations	$ 2,060,432	$ 1,306,998	$ —
Life and Annuity Operations	—	270,559	—
Financial Operations	—	—	165,150
Total	$ 2,060,432	$ 1,577,557	$ 165,150

(1) Other, includes bonding, warranty, accident and health and other lines of business.

Six months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 714,011	$ 181,348	$ —
Casualty	561,466	452,388	—
Property catastrophe	43,180	136,236	—
Other property	310,916	332,698	—
Marine, energy, aviation and satellite	391,612	85,272	—
Other (1)	115,693	169,010	—
Total general operations	$ 2,136,878	$ 1,356,952	$ —
Life and annuity operations	—	2,014,686	—
Financial operations	—	—	103,687

Total	$ 2,136,878	$ 3,371,638	$ 103,687

(1) Other, includes bonding, warranty, accident and health and other lines of business.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Derivative Instruments

The Company enters into investment, structured financial and weather and energy derivative instruments for both risk management and trading purposes. The Company also enters into credit derivatives in connection with its Financial Products and Services business. The Company is exposed to potential loss from various market risks and manages its market risks based on guidelines established by senior management. All these derivative instruments are carried at fair value.

The following table summarizes the net realized and unrealized gains on derivative instruments included in net income for the three and six months ended June 30, 2006 and 2005:

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
(U.S. dollars in thousands)	**2006**	**2005**	**2006**	**2005**
Credit derivatives	$ 2,644	$ (4,011)	$ 1,382	$ 6,238
Weather and energy risk management derivatives	1,938	4,112	22,926	10,166
Other non-investment derivatives	(695)	17,386	(1,493)	17,161
Net results from derivatives financial operations	$ 3,887	$ 17,487	$ 22,815	$ 33,565
Investment derivatives	25,351	(65,428)	55,274	(36,328)
Net realized and unrealized gains (losses) on derivatives	$ 29,238	$ (47,941)	$ 78,089	$ (2,763)

The Company records premiums received from sales of investment grade credit derivatives in gross written premiums and establishes loss reserves for this derivative business. These loss reserves represent the Company's best estimate of the probable losses expected under these contracts. Net realized and unrealized gains and losses on credit derivative instruments are computed as the difference between fair value and the net of unpaid losses and loss expenses and unpaid losses and loss expenses recoverable. Changes in unrealized gains and losses on credit derivative instruments are reflected in the consolidated statements of income. Cumulative unrealized gains and losses are reflected as assets and liabilities, respectively, in the Company's consolidated balance sheet. Net realized and unrealized gains and losses resulting from changes in the fair value of derivatives occur because of changes in interest rates, credit spreads, recovery rates, the credit ratings of the referenced entities and other market factors.

The following table summarizes insurance activities related to credit default swap derivative instruments excluding gains and losses on credit default swaps within the investment portfolio.

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
(U.S. dollars in thousands)	**2006**	**2005**	**2006**	**2005**
Statement of Income:				

Net earned premiums	$ 5,951	$ 6,269	$ 11,749	$ 14,446
Net losses and loss expenses	$ 503	$ (10,154)	$ 615	$ (8,028)
Net realized and unrealized gains (losses) on credit derivatives	$ 2,644	$ (4,011)	$ 1,382	$ 6,238

(U.S. dollars in thousands)	**(Unaudited) As at June 30, 2006**	**As at December 31, 2005**
Balance Sheet:		
Unpaid losses and loss expenses recoverable	$ 865	$ 471
Other assets	$ 13,994	$ 15,768
Unpaid losses and loss expenses	$ 16,397	$ 27,562
Other liabilities	$ 17,482	$ 20,142

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. Notes Payable and Debt and Financing Arrangements

The Company closed a new $500 million syndicated credit facility on May 9, 2006. The new facility has a tenor of 364-days and is available for letters of credit only.

7. Exposures under Guaranties

The Company provides financial guaranty insurance and reinsurance to support public and private borrowing arrangements. Financial guaranty insurance guarantees the timely payment of principal and interest on insured obligations to third party holders of such obligations in the event of default by an issuer. The Company's potential liability in the event of non-payment by the issuer of an insured or reinsured obligation represents the aggregate outstanding principal insured or reinsured under its policies and contracts and related interest payable at the date of default. In addition, the Company provides credit protection on specific referenced credits or on pools of specific referenced credits through the issuance of credit default swaps. Under the terms of credit default swaps, the seller of credit protection makes a specified payment to the buyer of credit protection upon the occurrence of one or more specified credit events with respect to a reference obligation or entity. The Company's potential liability under credit default swaps represents the notional amount of such swaps.

At June 30, 2006, the Company's net outstanding par exposure under its in-force financial guaranty insurance and reinsurance policies and contracts aggregated to $104.5 billion and net reserves for losses and loss adjustment expenses relating to such exposures was $167.3 million at such date. In addition, at June 30, 2006, the Company's notional exposure under credit default swaps aggregated to $17.7 billion and the net liability for these credit default swaps reflected in the Company's balance sheet at June 30, 2006 was $19.0 million.

8. XL Capital Finance (Europe) plc

XL Capital Finance (Europe) plc ("XLFE") is a wholly owned finance subsidiary of the XL Capital Ltd. In January 2002, XLFE issued $600.0 million par value 6.5% Guaranteed Senior Notes due January 2012. These Notes are fully and unconditionally guaranteed by the XL Capital Ltd. XL Capital Ltd's ability to obtain funds from its subsidiaries is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates including Bermuda, the U.S. and the U.K., among others. Required statutory capital and surplus for the principal operating subsidiaries of the Company was $4.1 billion as of December 31, 2005.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Computation of Earnings Per Ordinary Share and Ordinary Share Equivalent

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	2005	2006	2005
Basic earnings per ordinary share:				
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares outstanding	178,728	138,948	179,631	138,488
Basic earnings per ordinary share	$ 2.11	$ 0.98	$ 4.65	$ 4.18
Diluted earnings per ordinary share:				
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares outstanding basic	178,728	138,948	179,631	138,488
Average stock options outstanding (1)	470	1,456	438	1,353
Weighted average ordinary shares outstanding diluted	179,198	140,404	180,069	139,841
Diluted earnings per ordinary share	$ 2.10	$ 0.97	$ 4.64	$ 4.14
Dividends per ordinary share	$ 0.38	$ 0.50	$ 0.76	$ 1.00

(1) Net of shares repurchased under the treasury stock method.

10. Subsequent event sale of financial guaranty business

On August 1, 2006, the Company completed the sale of approximately 35 percent of its financial guaranty insurance and reinsurance businesses (the transferred business) through the initial public offering (IPO) of 22.4 million common shares of Security Capital Assurance Company Ltd. (SCA) at $20.50 per share. SCA was incorporated in Bermuda during March 2006 for the purpose of becoming a holding company for the transferred business. Subsequent to the IPO, the Company owns 42.2 million common shares, or approximately 65 percent of SCAs outstanding common shares. If the underwriters of the IPO fully exercise their option to purchase an additional 2.2 million common shares at the IPO price of $20.50 per share less the underwriting discount, the Company will ultimately retain 39.4 million common shares, or approximately 61% of SCA. Such option is exercisable through September 1, 2006.

In addition, as part of the overall structuring of the IPO transaction, certain formation transactions occurred in order to move all units included in the IPO under SCA. In addition, in connection with the IPO, the Company has entered into reinsurance agreements with SCA to retain certain insurance risks along with the related liabilities. At their inception, these contracts had no effect on the Companys income. In addition, the Company has entered into arrangements to provide adverse development protection to SCA related to certain limited risks where the Company would pay up to the limits of the underlying coverages. The Company has also entered into a number of agreements with SCA that will govern certain aspects of the relationship after the IPO, including service agreements under which the Company will provide certain services to SCA for a limited period of time.

Upon completion of the IPO, the Company received proceeds, of approximately $85.5 million. The Company expects the transaction to result in an estimated after tax loss in the range of $40.0 million to $60.0 million, representing the difference between the carrying value of 100% of SCA immediately prior to the IPO and the sum of the proceeds and remaining carrying value of XL Capitals ownership interest in SCA subsequent to the IPO. The ultimate loss within this range is dependent upon the equity of SCA as of the date of the IPO and will be reflected in the Companys operating results for the third quarter of 2006.

11. Restatement of Unaudited Consolidated Statements of Cash Flows

The Unaudited Consolidated Statements of Cash Flows for the six month periods ended June 30, 2006 and 2005 have been restated. The Company had incorrectly included the impact of foreign exchange rate changes on “Cash flows provided by operating activities,” “Cash flows used in investing activities”, “Cash flows provided by financing activities” and “Effects of exchange rate changes on foreign currency cash” in the Company’s Consolidated Statements of Cash Flows and, therefore, a restatement was required to eliminate the impact of those rate changes on balances held in certain foreign currency denominated subsidiaries from those financial statements

The following Condensed Statements of Consolidated Cash Flows for the six month periods ended June 30, 2006 and 2005 set forth the effects of these restatements:

	Six Months Ended June 30, 2006		
	As Previously Reported	**Adjustments**	**As Restated**
Net cash provided by operating activities	$ 1,281,480	$ (519,341)	$ 762,139
Net cash used in investing activities	(1,344,510)	496,782	(847,728)
Net cash used in financing activities	(1,062,700)	(2,156)	(1,064,856)
Effects of exchange rate changes on foreign currency cash	(977)	24,715	23,738
Net change in cash and cash equivalents	$ (1,126,707)	$ --	$ (1,126,707)
Cash and cash equivalents at the beginning of year	$ 3,693,475	$ --	$ 3,693,475
Cash and cash equivalents at the end of year	$ 2,566,768	$ --	$ 2,566,768

	Six Months Ended June 30, 2005		
	As Previously Reported	**Adjustments**	**As Restated**
Net cash provided by operating activities	$ 2,631,050	$ 575,715	$ 3,206,765
Net cash used in investing activities	(3,523,519)	(544,655)	(4,068,174)
Net cash provided by financing activities	1,065,717	260	1,065,977
Effects of exchange rate changes on foreign currency cash	(1,634)	(31,320)	(32,954)
Net change in cash and cash equivalents	$ 171,614	$ --	$ 171,614

Cash and cash equivalents at the beginning of year	$	2,203,726	$	--	$	2,203,726
Cash and Cash Equivalents at the end of the year	$	2,375,340	$	--	$	2,375,340

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The following is a discussion of the Company’s financial condition and liquidity and results of operations. Certain aspects of the Company’s business have loss experience characterized as low frequency and high severity. This may result in volatility in both the Company’s and an individual segment’s results of operations and financial condition.

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

Restatements

As further described in Note 11 to the Unaudited Consolidated Financial Statements, the Company has determined that certain adjustments are required to restate the Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003 and the three and six month periods ended March 31 and June 30, 2006, respectively. On November 5, 2006, management of XL Capital Ltd (the “Company”) determined that the Company had incorrectly included the impact of foreign exchange rate changes on “Cash flows provided by operating activities,” “Cash flows used in investing activities,” “Cash flows provided by financing activities” and “Effects of exchange rate changes on foreign currency cash” in the Company’s Consolidated Statements of Cash Flows and, therefore, a restatement is required to eliminate the impact of those rate changes on balances held in certain foreign currency denominated subsidiaries from those financial statements.

As a result of the restatement, “Net cash provided by operating activities” for the six months ended June 30, 2006 has been reduced to $762.1 million (from $1.3 billion previously reported), and for the first six months of 2005 has been increased to $3.2 billion (from $2.6 billion previously reported). No change will occur with respect to “Cash and cash equivalents” at the end of any period, and no restatement of the income statements or balance sheets is required.

The re-presentation of the Company’s Consolidated Statements of Cash Flows will not impact the Company’s previously reported Consolidated Statements of Income or Consolidated Balance Sheets and, in particular, “Cash and cash equivalents” reported at the end of any period in the Company’s Consolidated Statements of Cash Flows remains unchanged.

This discussion and analysis should be read in conjunction with the “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, and the audited Consolidated Financial Statements and notes thereto, presented under Item 7 and Item 8, respectively, of the Company’s Form 10-K/A for the year ended December 31, 2005.

Executive Overview

See “Executive Overview” in Item 7 of the Company’s Form 10-K/A for the year ended December 31, 2005.

Results of Operations

The following table presents an analysis of the Company’s net income available to ordinary shareholders and other financial measures (described below) for the three months ended June 30, 2006 and 2005:

(U.S. dollars and shares in thousands, except per share amounts) **(Unaudited)**

	Three Months Ended June 30,	
	2006	**2005**
Net income available to ordinary shareholders	$ 377,089	$ 135,895
Earnings per ordinary share basic	$ 2.11	$ 0.98
Earnings per ordinary share diluted	$ 2.10	$ 0.97
Weighted average number of ordinary shares and ordinary share equivalents basic	178,728	138,948
Weighted average number of ordinary shares and ordinary share equivalents diluted	179,198	140,404

The following table presents an analysis of the Company□s net income available to ordinary shareholders and other financial measures (described below) for the six months ended June 30, 2006 and 2005.

(U.S. dollars and shares in thousands, except per share amounts)	**(Unaudited) Six Months Ended June 30,**	
	2006	**2005**
Net income available to ordinary shareholders	$ 835,592	$ 578,840
Earnings per ordinary share □ basic	$ 4.65	$ 4.18
Earnings per ordinary share □ diluted	$ 4.64	$ 4.14
Weighted average number of ordinary shares and ordinary share equivalents □ basic	179,631	138,488
Weighted average number of ordinary shares and ordinary share equivalents □ diluted	180,069	139,841

The Company□s net income and other financial measures as shown below for the three and six months ended June 30, 2006 have been affected, among other things, by the following significant items:

1) Continuing competitive underwriting environment.

Overall market conditions remain attractive across most property and casualty lines.

In the insurance segment competitive forces have varied in different markets. Primary Casualty is competitive in a Excess Casualty market is generally flat on retained business, with certain lines of business, including healthcare, increases.

In Property insurance lines, the Company has significantly reduced overall catastrophe exposure while maintainin gross basis. However, increased reinsurance costs during the July 1, 2006 renewals will impact the Company□s ne the remainder of the year.

D&O rates are down approximately 6% across the year to date renewed book, with the market less competitive in Other Professional Liability pricing has been relatively stable with certain specialty lines showing improved pricin overall industry capacity reduction.

Pricing on the Company□s program business increased by over 50% on renewed business, heavily impacted by cat Company expects that the impact of these increases will diminish going forward, as risk management efforts will c catastrophe exposures.

In the reinsurance segment, July 1, 2006 property lines renewals have had premium rate increases in excess of 10 the 2005 natural catastrophes and other U.S. property lines had rate increases of between 20% and 100% dependi are hurricane exposed. A few large European property programs renew mid year and these programs have had 15

U.S. Casualty reinsurance rates remain attractive, with treaty rates flat to slightly down but facultative rates still r

The Company□s results have also been impacted during the first six months of 2006 by the overall risk management initiatives put in place to reduce catastrophe exposure to property and marine and offshore energy lines of business. The Company has reduced its aggregate catastrophe exposure in the six months ended June 30, 2006 through selective underwriting in areas such as the Gulf of Mexico and the exclusion of certain risks where possible. The Company has also generally made higher reinsurance cessions on most short tail lines, in particular to Cyrus Reinsurance Limited, which covers property catastrophe reinsurance and retrocessional business. The impact of these initiatives was most notable in net premiums written in the first half of 2006 and these initiatives are expected to negatively impact net premiums earned over the balance of the year.

2) Growing asset base and positive contribution from investment affiliates.

Net investment income was $937.4 million for the six months ended June 30, 2006 compared to $675.6 million for the same period in 2005. This increase resulted from a larger investment base combined with higher investment yields primarily due to increases in U.S. interest rates. The increase in the size of the investment portfolio resulted from equity raised in the fourth quarter of 2005, growth in structured and spread balances and positive cash flows from operations.

Net income from investment affiliates was $135.2 million for the six months ended June 30, 2006, compared to $59.7 million for the same period in 2005. These results reflect strong returns from the Company□s alternative fund investments during the first half of 2006, as well as strong results from certain private equity investments.

Financial Measures

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

(U.S. dollars in thousands, except ratios and per share amounts)

	(Unaudited) Three Months Ended June 30,	
	2006	**2005**
Underwriting profit □ general operations	$ 150,693	$ 45,368
Combined ratio □ general operations	90.0%	97.9%
Investment income □ general operations	$ 261,441	$ 209,727

	(Unaudited) Six Months Ended June 30,	
	2006	**2005**
Underwriting profit □ general operations	$ 300,331	$ 220,808
Combined ratio □ general operations	89.8%	93.7%
Investment income □ general operations	$ 523,808	$ 381,657
Annualized return on average ordinary shareholders□ equity	20.9%	15.4%

	(Unaudited) June 30, 2006	**December 31, 2005**
Book value per ordinary share	$ 44.51	$ 44.31

Underwriting profit general operations

One way the Company evaluates the performance of its property and casualty insurance and reinsurance general operations is the underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned and fee income, less net losses incurred and expenses related to the underwriting activities. Underwriting profits in the three and six month periods ended June 30, 2006 are primarily reflective of the combined ratio discussed below.

Combined ratio general operations

The combined ratio for general operations is used by the Company, and many other property and casualty insurance and reinsurance companies, as another 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 the Companys general insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss. Decreases in the Companys combined ratio for the three and six months ended June 30, 2006, compared to the same periods in the previous year, were primarily a result of a lower loss and loss expense ratio partially offset by an increasing underwriting expense ratio. The decrease in the loss and loss expense ratio was primarily due to the absence of the U.S. casualty reinsurance charge which took place in the second quarter of 2005, partially offset by continued pricing pressures across most lines of business. The increased underwriting expanse ratio has been driven largely by the reduced earned premium levels.

Net investment income general operations

Net investment income from the Companys general operations is an important measure that affects the Companys overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Companys investment portfolio provides liquidity for claims settlements of these reserves as they become due and thus a significant part of the portfolio is in fixed income securities. Net investment income is affected by the size of the portfolio and also overall market interest rates. The average size of the investment portfolio outstanding during the three and six months ended June 30, 2006 increased as compared to the same periods in 2005 due to the Companys issuance of ordinary shares and equity units in the fourth quarter of 2005 and its positive operating cash flow. Total investments as at June 30, 2006 were $38.9 billion as compared to $33.9 billion as at June 30, 2005. Interest rates in the United States have risen since the second quarter of 2005, which also contributed to the increase in investment income.

Book value per ordinary share

Management also views the Companys book value per ordinary share as an additional measure of the Companys performance. Book value per ordinary share is calculated by dividing ordinary shareholders equity by the number of outstanding ordinary shares at any period end. Book value per ordinary share is affected primarily by the Companys net income (loss) and also by any changes in the net unrealized gains and losses on its investment portfolio. Book value per ordinary share has increased by $0.20 in the first half of 2006 as compared to an increase of $3.97 in the first half of 2005. The factors noted above have created $835.6 million in net income for the six months ended June 30, 2006, which increases book value. However, the net unrealized gains associated with the Companys investment portfolio as at December 31, 2005 have decreased by $756.5 million net of tax for the first six months of 2006 resulting in a net unrealized loss position. This decline was driven primarily by increasing interest rates in the U.S., U.K. and the Euro zone. Book value declined as at June 30, 2006, compared with that as at June 30, 2005, due to the net positive impact of the above items being more than offset by the increased average number of shares outstanding following the Companys issuance of common shares in the fourth quarter of 2005.

Other Key Focuses of Management

See the discussion of the Other Key Focuses of Management in Item 7 of the Companys Form 10-K/A for the year ended December 31, 2005. That discussion is updated with the disclosures set forth below.

Initial Public Offering of Financial Guarantee Business

On August 1, 2006, the Company completed the sale of approximately 35 percent of its financial guaranty insurance and reinsurance businesses (the transferred business) through the initial public offering (IPO) of 22.4 million common shares of Security Capital Assurance Company Ltd (SCA) at $20.50 per share. SCA was incorporated in Bermuda during March 2006 for the purpose of becoming a holding company for the transferred business. Subsequent to the IPO, the Company owns 42.2 million common shares, or approximately 65 percent of SCAs outstanding common shares. If the underwriters of the IPO fully exercise their option to purchase an additional 2.2 million common shares at the IPO price of $20.50 per share less the underwriting discount, the Company will ultimately retain 39.4 million common shares, or approximately 61% of SCA. Such option is exercisable through September 1, 2006.

In addition, as part of the overall structuring of the IPO transaction, certain formation transactions occurred in order to move all units included in the IPO under SCA. In addition, in connection with the IPO, the Company has entered into reinsurance agreements with SCA to retain certain insurance risks along with the related liabilities. At their inception, these contracts had no effect on the Companys income. In addition, the Company has entered into arrangements to provide adverse development protection to SCA related to certain limited risks where the Company would pay up to the limits of the underlying coverages. The Company has also entered into a number of agreements with SCA that will govern certain aspects of the relationship after the IPO, including service agreements under which the Company will provide certain services to SCA for a limited period of time.

Upon completion of the IPO the Company received proceeds, of approximately $85.5 million. The Company expects the transaction to result in an estimated after tax loss in the range of $40.0 million to $60.0 million, representing the difference between the carrying value of 100% of SCA immediately prior to the IPO and the sum of the proceeds and remaining carrying value of XL Capitals ownership interest in SCA subsequent to the IPO. The ultimate loss within this range is dependent upon the equity of SCA as of the date of the IPO and will be reflected in the Companys operating results for the third quarter of 2006.

Ratings and Capital Management

The Companys ability to underwrite business is dependent upon the quality of its claim paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Companys financial strength rating was downgraded, its ability to write business may be adversely affected.

In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claim paying and financial strength ratings. The Company is actively working to address these needs with several key business initiatives.

To address these needs, management entered into certain catastrophe risk reduction measures and strategic initiatives intended to reduce volatility while, at the same time, improving the quality of the Companys risk adjusted returns. These measures include the Companys cessions to Cyrus Reinsurance Limited and reducing the Companys catastrophe exposures in the Companys Global Risk Property Insurance book, the International Catastrophe Insurance Managers, LLC portfolio (iCAT), the Reinsurance Property Risk book and our Offshore Marine & Energy books in both Insurance and Reinsurance.

Management Structure

A new Office of the Chief Executive Officer (OCEO) has been formed effective July 1, 2006. It is comprised of five senior executive functions including the Companys Chief Financial Officer, Chief Investment Officer (designate), Chief Executive - Global Business Services and two newly-created roles, Chief Operating Officer and Chief of Staff. This new structure is designed to provide a focused, enterprise-wide framework to allow the Companys business leaders to leverage strategic opportunities and execute on business priorities.

Henry C.V. Keeling, formerly Global Head of Business Services and Chief Executive of Reinsurance Life Operations, has been appointed Chief Operating Officer. Mr. Keeling assumes broad strategic responsibility for the Company's underwriting risk assumption businesses, including insurance, general reinsurance, life reinsurance and financial products. Clive Tobin, Chief Executive Officer Insurance, and Jamie Veghte, Chief Executive Officer Reinsurance General Operations, continue in those roles, as members of the Company's Executive Management Board and as the key leaders of the Company's property and casualty segments, reporting to Mr. Keeling.

Fiona E. Luck, formerly Global Head of Corporate Services, has been appointed Chief of Staff. In her new position, Ms. Luck is responsible for management of the Company's Legal and Corporate Actuarial functions in addition to her existing role managing a wide range of other holding company functions including Corporate Strategy, Human Resources, Corporate Communications, Marketing and Corporate Social Responsibility.

Jerry de St. Paer and Sarah E. Street continue in their roles as Chief Financial Officer and Chief Investment Officer (designate), respectively, and will become part of the OCEO.

Mr. Michael C. Lobdell, a former Managing Director of New York-based JPMorganChase, will join the Company in September to serve as Chief Executive - Global Business Services. Mr. Lobdell will be responsible for overall execution and service delivery across the entire company and will oversee infrastructure and project management, including IT systems and technology, procurement, real estate, facilities, outsourcing and offshoring.

Winterthur International

Under the terms of the Sale and Purchase Agreement (the "SPA"), as amended, between XL Insurance (Bermuda) Ltd ("XLI") and Winterthur Swiss Insurance Company ("WSIC"), WSIC provided the Company with post-closing protection determined as of June 30, 2004 with respect to, among other things, adverse development of reserves and premium on certain Winterthur International Insurance business. This protection was