

XL GROUP PLC
Form 10-Q
August 08, 2012

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 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)

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

Indicate by 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 such shorter period that the registrant was required to submit and post such files). Yes No

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

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Large accelerated filer 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

As of August 6, 2012, there were 305,705,727 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

XL GROUP PLC

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL GROUP PLC

UNAUDITED CONSOLIDATED BALANCE SHEETS

| <i>(U.S. dollars in thousands, except share data)</i> | June 30, 2012 | December 31, 2011 |
|---|--------------------------|------------------------------|
| ASSETS | | |
| Investments: | | |
| Fixed maturities, at fair value (amortized cost: 2012: \$25,442,779; 2011: \$25,771,715) | \$ 26,242,802 | \$ 26,190,025 |
| Equity securities, at fair value (cost: 2012: \$553,715; 2011: \$480,685) | 529,056 | 468,197 |
| Short-term investments, at fair value (amortized cost: 2012: \$227,321; 2011: \$359,378) | 227,380 | 359,063 |
| Total investments available for sale | \$ 26,999,238 | \$ 27,017,285 |
| Fixed maturities, held to maturity at amortized cost (fair value: 2012: \$3,006,992; 2011: \$2,895,688) | 2,716,357 | 2,668,978 |
| Investments in affiliates | 1,024,353 | 1,052,729 |
| Other investments | 1,208,220 | 985,262 |
| Total investments | \$ 31,948,168 | \$ 31,724,254 |
| Cash and cash equivalents | 3,311,146 | 3,825,125 |
| Accrued investment income | 323,898 | 331,758 |
| Deferred acquisition costs | 723,597 | 647,113 |
| Ceded unearned premiums | 744,548 | 596,895 |
| Premiums receivable | 3,107,931 | 2,411,611 |
| Reinsurance balances receivable | 223,187 | 220,017 |
| Unpaid losses and loss expenses recoverable | 3,342,628 | 3,654,948 |
| Receivable from investments sold | 57,549 | 59,727 |
| Goodwill and other intangible assets | 405,516 | 407,321 |
| Deferred tax asset | 132,508 | 115,601 |
| Other assets | 619,480 | 670,895 |
| Total assets | \$ 44,940,156 | \$ 44,665,265 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Liabilities: | | |
| Unpaid losses and loss expenses | \$ 19,961,950 | \$ 20,613,901 |
| Deposit liabilities | 1,600,595 | 1,608,108 |
| Future policy benefit reserves | 4,740,907 | 4,845,394 |
| Unearned premiums | 4,231,975 | 3,555,310 |
| Notes payable and debt | 1,673,921 | 2,275,327 |
| Reinsurance balances payable | 516,886 | 90,552 |
| Payable for investments purchased | 51,683 | 58,494 |
| Deferred tax liability | 154,497 | 91,104 |
| Other liabilities | 793,940 | 770,945 |
| Total liabilities | \$ 33,726,354 | \$ 33,909,135 |
| Commitments and Contingencies | | |
| Shareholders' Equity: | | |
| Ordinary shares, 999,990,000 authorized, par value \$0.01; issued and outstanding: (2012: 305,692,155; 2011: 315,645,796) | \$ 3,057 | \$ 3,156 |

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| | | |
|---|----------------------|----------------------|
| Additional paid in capital | 8,738,204 | 8,938,679 |
| Accumulated other comprehensive income | 910,760 | 583,064 |
| Retained earnings (deficit) | 215,788 | (113,241) |
| Shareholders' equity attributable to XL Group plc | \$ 9,867,809 | \$ 9,411,658 |
| Non-controlling interest in equity of consolidated subsidiaries | 1,345,993 | 1,344,472 |
| Total shareholders' equity | \$ 11,213,802 | \$ 10,756,130 |
| Total liabilities and shareholders' equity | \$ 44,940,156 | \$ 44,665,265 |

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|--------------|------------------------------|--------------|
| | 2012 | 2011 | 2012 | 2011 |
| <i>(U.S. dollars in thousands, except per share data)</i> | | | | |
| Revenues: | | | | |
| Net premiums earned | \$ 1,486,595 | \$ 1,398,339 | \$ 2,923,013 | \$ 2,759,722 |
| Net investment income | 262,631 | 296,505 | 527,873 | 576,768 |
| Realized investment gains (losses): | | | | |
| Net realized gains (losses) on investments sold | 15,800 | 17,632 | 57,568 | (11,360) |
| Other-than-temporary impairments on investments | (16,168) | (40,088) | (34,733) | (73,808) |
| Other-than-temporary impairments on investments transferred to (from) other comprehensive income | (12,025) | 12,912 | (14,425) | 9,187 |
| Total net realized gains (losses) on investments | \$ (12,393) | \$ (9,544) | \$ 8,410 | \$ (75,981) |
| Net realized and unrealized gains (losses) on derivative instruments | (4,300) | (10,950) | (3,598) | (7,383) |
| Income (loss) from investment fund affiliates | 3,097 | 10,250 | 22,505 | 37,400 |
| Fee income and other | 11,109 | 10,582 | 20,968 | 19,514 |
| Total revenues | \$ 1,746,739 | \$ 1,695,182 | \$ 3,499,171 | \$ 3,310,040 |
| Expenses: | | | | |
| Net losses and loss expenses incurred | \$ 826,355 | \$ 823,584 | \$ 1,680,420 | \$ 2,032,449 |
| Claims and policy benefits | 131,150 | 137,416 | 252,457 | 270,647 |
| Acquisition costs | 218,937 | 215,099 | 443,088 | 403,589 |
| Operating expenses | 299,052 | 266,142 | 581,463 | 527,134 |
| Exchange (gains) losses | (17,976) | (8,498) | (5,258) | 1,016 |
| Interest expense | 57,360 | 55,099 | 96,658 | 109,246 |
| Total expenses | \$ 1,514,878 | \$ 1,488,842 | \$ 3,048,828 | \$ 3,344,081 |
| Income (loss) before income tax and income (loss) from operating affiliates | \$ 231,861 | \$ 206,340 | \$ 450,343 | \$ (34,041) |
| Income (loss) from operating affiliates | 22,561 | 46,251 | 38,814 | 59,887 |
| Provision (benefit) for income tax | 29,812 | 24,826 | 51,362 | (7,971) |
| Net income (loss) | \$ 224,610 | \$ 227,765 | \$ 437,795 | \$ 33,817 |
| Non-controlling interests | (3,454) | (2,102) | (40,011) | (35,438) |
| Net income (loss) attributable to XL Group plc and ordinary shareholders | \$ 221,156 | \$ 225,663 | \$ 397,784 | \$ (1,621) |
| Weighted average ordinary shares and ordinary share equivalents outstanding basic | 309,765 | 309,184 | 312,442 | 310,325 |
| Weighted average ordinary shares and ordinary share equivalents outstanding diluted | 312,435 | 341,989 | 315,010 | 310,325 |
| Earnings (loss) per ordinary share and ordinary share equivalent basic | \$ 0.71 | \$ 0.73 | \$ 1.27 | \$ (0.01) |
| | \$ 0.71 | \$ 0.69 | \$ 1.26 | \$ (0.01) |

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Earnings (loss) per ordinary share and ordinary share
equivalent diluted

See accompanying Notes to Unaudited Consolidated Financial Statements

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XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| <i>(U.S. dollars in thousands)</i> | | | | |
| Net income (loss) attributable to XL Group plc | \$ 221,156 | \$ 225,663 | \$ 397,784 | \$ (1,621) |
| Change in net unrealized gains (losses) on investments, net of tax | 109,333 | 167,827 | 321,657 | 181,206 |
| Change in net unrealized gains (losses) on affiliate and other investments, net of tax | 1,333 | 8,431 | 16,383 | 32,666 |
| Change in OTTI losses recognized in other comprehensive income, net of tax | 13,996 | (1,183) | 26,417 | 24,124 |
| Change in underfunded pension liability | 167 | (53) | (7) | (397) |
| Change in value of cash flow hedge | 110 | 110 | 220 | 220 |
| Foreign currency translation adjustments | (45,695) | 72,741 | (36,974) | 84,357 |
| Comprehensive income (loss) | \$ 300,400 | \$ 473,536 | \$ 725,480 | \$ 320,555 |

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

| | Six Months Ended June 30, | |
|---|------------------------------|----------------------|
| <i>(U.S. dollars in thousands)</i> | 2012 | 2011 |
| Ordinary Shares: | | |
| Balance - beginning of year | \$ 3,156 | \$ 3,165 |
| Issuance of ordinary shares | 9 | 3 |
| Buybacks of ordinary shares | (109) | (116) |
| Exercise of stock options | 1 | - |
| Balance - end of period | \$ 3,057 | \$ 3,052 |
| Additional Paid in Capital: | | |
| Balance - beginning of year | \$ 8,938,679 | \$ 8,993,016 |
| Issuance of ordinary shares | 1,376 | 976 |
| Buybacks of ordinary shares | (225,869) | (258,787) |
| Exercise of stock options, net of tax | 1,349 | 1,087 |
| Share based compensation expense | 22,669 | 20,008 |
| Balance - end of period | \$ 8,738,204 | \$ 8,756,300 |
| Accumulated Other Comprehensive Income (Loss): | | |
| Balance - beginning of year | \$ 583,064 | \$ 100,795 |
| Change in net unrealized gains (losses) on investments, net of tax | 321,657 | 181,206 |
| Change in net unrealized gains (losses) on affiliate and investments, net of tax | 16,383 | 32,666 |
| Change in OTTI losses recognized in other comprehensive income, net of tax | 26,417 | 24,124 |
| Change in underfunded pension liability | (7) | (397) |
| Change in value of cash flow hedge | 220 | 220 |
| Foreign currency translation adjustments | (36,974) | 84,357 |
| Balance - end of period | \$ 910,760 | \$ 422,971 |
| Retained Earnings (Deficit): | | |
| Balance - beginning of year | \$ (113,241) | \$ 500,497 |
| Net income attributable to XL Group plc | 397,784 | (1,621) |
| Dividends on ordinary shares | (68,755) | (68,529) |
| Balance - end of period | \$ 215,788 | \$ 430,347 |
| Non-controlling Interest in Equity of Consolidated Subsidiaries: | | |
| Balance - beginning of year | \$ 1,344,472 | \$ 1,002,296 |
| Non-controlling interests - contribution | 1,500 | - |
| Non-controlling interests | (12) | 1 |
| Non-controlling interest share in change in accumulated other comprehensive income (loss) | 33 | (16) |
| Purchase of Series E preference ordinary shares | - | (500) |
| Balance - end of period | \$ 1,345,993 | \$ 1,001,781 |
| Total Shareholders Equity | \$ 11,213,802 | \$ 10,614,451 |

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six Months Ended June 30, | |
|---|------------------------------|-------------------|
| <i>(U.S. dollars in thousands)</i> | 2012 | 2011 |
| Cash flows provided by (used in) operating activities: | | |
| Net income (loss) | \$ 437,795 | \$ 33,817 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Net realized (gains) losses on investments | (8,410) | 75,981 |
| Net realized and unrealized (gains) losses on derivative instruments | 3,598 | 7,383 |
| Amortization of premiums (discounts) on fixed maturities | 75,240 | 42,939 |
| (Income) loss from investment and operating affiliates | (61,319) | (97,287) |
| Share based compensation | 27,795 | 22,872 |
| Depreciation | 27,479 | 24,248 |
| Accretion of deposit liabilities | 49,852 | 40,281 |
| Unpaid losses and loss expenses | (531,503) | 67,088 |
| Future policy benefit reserves | (88,679) | (61,147) |
| Unearned premiums | 718,750 | 622,665 |
| Premiums receivable | (739,817) | (652,203) |
| Unpaid losses and loss expenses recoverable | 300,429 | 57,390 |
| Ceded unearned premiums | (153,792) | (184,010) |
| Reinsurance balances receivable | (4,959) | 37,536 |
| Deferred acquisition costs | (60,901) | (79,060) |
| Reinsurance balances payable | 427,573 | 279,074 |
| Deferred tax asset - net | 22,328 | (51,297) |
| Derivatives | 28,383 | (46,619) |
| Other assets | 26,077 | 38,458 |
| Other liabilities | 17,389 | (95,299) |
| Other | (29,712) | 24,517 |
| Total adjustments | \$ 45,801 | \$ 73,510 |
| Net cash provided by (used in) operating activities | \$ 483,596 | \$ 107,327 |
| Cash flows provided by (used in) investing activities: | | |
| Proceeds from sale of fixed maturities and short-term investments | \$ 1,972,342 | \$ 2,489,705 |
| Proceeds from redemption of fixed maturities and short-term investments | 2,280,398 | 1,325,898 |
| Proceeds from sale of equity securities | 123,181 | 157,727 |
| Purchases of fixed maturities and short-term investments | (4,093,947) | (3,527,609) |
| Purchases of equity securities | (197,653) | (381,918) |
| Net dispositions of investment affiliates | 38,437 | 11,684 |
| Other investments, net | (128,281) | 8,877 |
| Net cash provided by (used in) investing activities | \$ (5,523) | \$ 84,364 |
| Cash flows provided by (used in) financing activities: | | |
| Proceeds from issuance of ordinary shares and exercise of stock options | \$ 1,214 | \$ 1,089 |
| Buybacks of ordinary shares | (225,978) | (258,903) |
| Dividends paid on ordinary shares | (68,315) | (68,073) |
| Distributions to non-controlling interests | (39,930) | (35,599) |
| Contribution from non-controlling interest | 1,500 | - |
| Repayment of debt | (600,000) | - |
| Deposit liabilities | (56,910) | (52,565) |

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| | | | | |
|--|----|-----------|----|-----------|
| Net cash provided by (used in) financing activities | \$ | (988,419) | \$ | (414,051) |
| Effects of exchange rate changes on foreign currency cash | | (3,633) | | 58,834 |
| Increase (decrease) in cash and cash equivalents | \$ | (513,979) | \$ | (163,526) |
| Cash and cash equivalents - beginning of period | | 3,825,125 | | 3,022,868 |
| Cash and cash equivalents - end of period | \$ | 3,311,146 | \$ | 2,859,342 |

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

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

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 disclosures required by GAAP for complete financial statements. In addition, the year-end balance sheet data were derived from audited financial statements but do not include all disclosures required by GAAP. In the opinion of management, these unaudited financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair statement of financial position and results of operations 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 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.

2. Significant Accounting Policies

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 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 has 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies

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. However, a separate accounting standards update issued in December 2011 deferred indefinitely a provision within the original standard requiring entities to present components of reclassifications of other comprehensive income on the face of the income statement. 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.

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 in FASB Accounting Standards Codification Topic 350. 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 test 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 amendments do not change the current guidance for testing other indefinite-lived intangible assets for impairment. The Company adopted this guidance from January 1, 2012. It did not have an impact on the Company's consolidated financial condition or results of operations.

3. Fair Value Measurements

Fair value is defined as the amount that would be received for the sale of an asset or paid to transfer a liability (an exit price), in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants as of the measurement date. Applicable accounting guidance provides an established hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors that market participants would use in valuing the asset or liability. Assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurements. The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy.

The fair values for available for sale investments are generally sourced from third parties. The fair value of fixed income securities is 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 quotes where pricing services do not provide coverage for a particular security. 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.

The Company performs regular reviews of the prices received from its third party valuation sources to assess if 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 taken by the Company include, but are not limited to, annual reviews of the controls of the external parties responsible for sourcing valuations, which are subjected to automated tolerance checks, quarterly reviews of the valuation sources and dates, and monthly reconciliations between the valuations provided by our external parties and valuations provided by our third party investment managers at a portfolio level.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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. The Company obtains 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, 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.

For further information, see Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

(a) Fair Value Summary

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at June 30, 2012 and December 31, 2011 by level within the fair value hierarchy:

| June 30, 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 at June 30, 2012 |
|---|---|---|---|--|--------------------------------|
| Assets | | | | | |
| U.S. Government and Government - Related/Supported | \$ - | \$ 2,101,625 | \$ - | \$ - | \$ 2,101,625 |
| Corporate (1) (2) | - | 9,687,642 | 33,511 | - | 9,721,153 |
| Residential mortgage-backed securities Agency (RMBS - Agency) | - | 5,149,725 | 52,588 | - | 5,202,313 |
| Residential mortgage-backed securities Non-Agency (RMBS - Non-Agency) | - | 582,947 | 1,596 | - | 584,543 |
| Commercial mortgage-backed securities (CMBS) | - | 904,792 | - | - | 904,792 |
| Collateralized debt obligations (CDO) | - | 7,839 | 642,179 | - | 650,018 |
| Other asset-backed securities (2) | - | 1,382,490 | 25,248 | - | 1,407,738 |
| U.S. States and political subdivisions of the States | - | 1,764,431 | - | - | 1,764,431 |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | - | 3,906,189 | - | - | 3,906,189 |
| Total fixed maturities, at fair value | \$ - | \$ 25,487,680 | \$ 755,122 | \$ - | \$ 26,242,802 |
| Equity securities, at fair value (3) | 273,427 | 255,629 | - | - | 529,056 |
| Short-term investments, at fair value (1)(4) | - | 227,380 | - | - | 227,380 |
| Total investments available for sale | \$ 273,427 | \$ 25,970,689 | \$ 755,122 | \$ - | \$ 26,999,238 |
| Cash equivalents (5) | 1,750,569 | 710,712 | - | - | 2,461,281 |
| Other investments (6) | - | 776,438 | 117,765 | - | 894,203 |
| Other assets (7) | - | 178,104 | - | (124,674) | 53,430 |
| Total assets accounted for at fair value | \$ 2,023,996 | \$ 27,635,943 | \$ 872,887 | \$ (124,674) | \$ 30,408,152 |
| Liabilities | | | | | |

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| | | | | | | | | |
|--|----|---|-----------|----|--------|----|---|-----------|
| Financial instruments sold, but not yet purchased (8) | \$ | - | \$ 28,198 | \$ | - | \$ | - | \$ 28,198 |
| Other liabilities (7) | | - | 10,578 | | 35,947 | | - | 46,525 |
| Total liabilities accounted for at fair value | \$ | - | \$ 38,776 | \$ | 35,947 | \$ | - | \$ 74,723 |

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XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

| 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 | Balance at December 31, 2011 |
|---|---|---|---|--|------------------------------------|
| Assets | | | | | |
| U.S. Government and Government - Related/Supported | \$ - | \$ 1,990,983 | \$ - | \$ - | \$ 1,990,983 |
| Corporate (1) (2) | - | 10,084,804 | 23,818 | - | 10,108,622 |
| RMBS Agency | - | 5,347,365 | 32,041 | - | 5,379,406 |
| RMBS Non-Agency | - | 641,815 | - | - | 641,815 |
| CMBS | - | 974,835 | - | - | 974,835 |
| CDO | - | 7,751 | 650,851 | - | 658,602 |
| Other asset-backed securities (2) | - | 1,323,697 | 16,552 | - | 1,340,249 |
| U.S. States and political subdivisions of the States | - | 1,797,378 | - | - | 1,797,378 |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | - | 3,298,135 | - | - | 3,298,135 |
| Total fixed maturities, at fair value (2) | \$ - | \$ 25,466,763 | \$ 723,262 | \$ - | \$ 26,190,025 |
| Equity securities, at fair value (3) | 239,175 | 229,022 | - | - | 468,197 |
| Short-term investments, at fair value (1)(4) | - | 359,063 | - | - | 359,063 |
| Total investments available for sale | \$ 239,175 | \$ 26,054,848 | \$ 723,262 | \$ - | \$ 27,017,285 |
| Cash equivalents (5) | 1,686,101 | 1,068,264 | - | - | 2,754,365 |
| Other investments (6) | - | 547,598 | 113,959 | - | 661,557 |
| Other assets (7) | - | 143,622 | - | (77,888) | 65,734 |
| Total assets accounted for at fair value | \$ 1,925,276 | \$ 27,814,332 | \$ 837,221 | \$ (77,888) | \$ 30,498,941 |
| Liabilities | | | | | |
| Financial instruments sold, but not yet purchased (8) | \$ - | \$ 20,844 | \$ - | \$ - | \$ 20,844 |
| Other liabilities (7) | - | 16,871 | 42,644 | (809) | 58,706 |
| Total liabilities accounted for at fair value | \$ - | \$ 37,715 | \$ 42,644 | \$ (809) | \$ 79,550 |

- (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 \$186.1 million and \$266.0 million and an amortized cost of \$199.1 million and \$297.7 million at June 30, 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 June 30, 2012, Covered Bonds within Total fixed maturities with a fair value of \$500.5 million are included within Other 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.

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- (3) Included within Equity securities are investments in fixed income funds with a fair value of \$95.8 million and \$91.6 million at June 30, 2012 and December 31, 2011, respectively.
- (4) Short-term investments consist primarily of Corporate securities and 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 that totaled \$314.0 million at June 30, 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 Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011
- (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, the Company held net cash collateral related to derivative positions of approximately \$124.7 million and \$77.1 million at June 30, 2012 and December 31, 2011, respectively. This balance is included within cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative positions 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.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(b) Level 3 Gains and Losses

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 reflect gains and losses for the three and six months ended June 30, 2012 and 2011 for all financial assets and liabilities categorized as Level 3 at June 30, 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 June 30, 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 transfers between Level 1 and Level 2 during the three and six month periods ended June 30, 2012 and 2011.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

Level 3 Assets and Liabilities - Three Months Ended June 30, 2012

| <i>(U.S. dollars in thousands)</i> | Corporate | RMBS - Agency | RMBS - Non Agency | CMBS | CDO |
|---|-----------|---------------|-------------------|------|------------|
| Balance, beginning of period | \$ 33,305 | \$ 39,795 | \$ - | \$ - | \$ 638,697 |
| Realized gains (losses) | 82 | (30) | - | - | 57 |
| Movement in unrealized gains (losses) | 94 | 195 | - | - | 6,186 |
| Purchases and issuances | - | 35 | - | - | - |
| Sales and settlements | (213) | (4,345) | - | - | (1,488) |
| Transfers into Level 3 | 536 | 16,938 | 1,596 | - | - |
| Transfers out of Level 3 | (293) | - | - | - | (1,273) |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 33,511 | \$ 52,588 | \$ 1,596 | \$ - | \$ 642,179 |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 94 | \$ 197 | \$ - | \$ - | \$ 6,186 |

Level 3 Assets and Liabilities - Three Months Ended June 30, 2012

| <i>(U.S. dollars in thousands)</i> | 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 | \$ 16,410 | \$ - | \$ - | \$ 115,659 | \$ (40,630) |
| Realized gains (losses) | (135) | - | - | 510 | - |
| Movement in unrealized gains (losses) | 4,145 | - | - | 3,616 | 4,683 |
| Purchases and issuances | - | - | - | 2,365 | - |
| Sales and settlements | (844) | - | - | (4,080) | - |
| Transfers into Level 3 | 5,672 | - | - | - | - |
| Transfers out of Level 3 | - | - | - | (305) | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 25,248 | \$ - | \$ - | \$ 117,765 | \$ (35,947) |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 3,918 | \$ - | \$ - | \$ 1,326 | \$ 4,683 |

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

Level 3 Assets and Liabilities - Three Months Ended June 30, 2011

| <i>(U.S. dollars in thousands)</i> | Corporate | RMBS - Agency | RMBS - Non Agency | CMBS | CDO |
|---|-----------|---------------|-------------------|----------|------------|
| Balance, beginning of period | \$ 34,885 | \$ 32,987 | \$ 3,335 | \$ 1,757 | \$ 742,551 |
| Realized gains (losses) | (247) | - | - | 207 | (419) |
| Movement in unrealized gains (losses) | 353 | 61 | (22) | (527) | 9,633 |
| Purchases and issuances | - | - | - | 3,155 | 2,379 |
| Sales and settlements | (7,567) | (165) | (119) | (29) | (29,530) |
| Transfers into Level 3 | - | 11,276 | - | - | 2,625 |
| Transfers out of Level 3 | (22,638) | (28,774) | - | - | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 4,786 | \$ 15,385 | \$ 3,194 | \$ 4,563 | \$ 727,239 |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 71 | \$ 61 | \$ (22) | \$ (320) | \$ 8,419 |

Level 3 Assets and Liabilities - Three Months Ended June 30, 2011

| <i>(U.S. dollars in thousands)</i> | 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 | \$ 12,371 | \$ - | \$ - | \$ 144,834 | \$ (36,810) |
| Realized gains (losses) | 161 | - | - | 12,155 | - |
| Movement in unrealized gains (losses) | 4,688 | - | - | (1,982) | (12,725) |
| Purchases and issuances | - | - | - | 6,254 | - |
| Sales and settlements | (172) | - | - | (46,421) | (110) |
| Transfers into Level 3 | - | - | - | - | - |
| Transfers out of Level 3 | - | - | - | (300) | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 17,048 | \$ - | \$ - | \$ 114,540 | \$ (49,645) |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 4,878 | \$ - | \$ - | \$ 9,285 | \$ (12,725) |

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

Level 3 Assets and Liabilities - Six Months Ended June 30, 2012

| <i>(U.S. dollars in thousands)</i> | Corporate | RMBS - Agency | RMBS - Non Agency | CMBS | CDO |
|---|-----------|---------------|-------------------|------|------------|
| Balance, beginning of period | \$ 23,818 | \$ 32,041 | \$ - | \$ - | \$ 650,851 |
| Realized gains (losses) | (42) | (96) | - | - | (1,612) |
| Movement in unrealized gains (losses) | 1,255 | (95) | - | - | 39,379 |
| Purchases and issuances | 8,734 | 70 | - | - | - |
| Sales and settlements | (1,608) | (3,211) | - | - | (44,835) |
| Transfers into Level 3 | 1,354 | 23,879 | 1,596 | - | - |
| Transfers out of Level 3 | - | - | - | - | (1,604) |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 33,511 | \$ 52,588 | \$ 1,596 | \$ - | \$ 642,179 |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 1,255 | \$ (95) | \$ - | \$ - | \$ 35,379 |

Level 3 Assets and Liabilities - Six Months Ended June 30, 2012

| <i>(U.S. dollars in thousands)</i> | 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 | \$ 16,552 | \$ - | \$ - | \$ 113,959 | \$ (42,644) |
| Realized gains (losses) | (94) | - | - | 2,438 | - |
| Movement in unrealized gains (losses) | 3,905 | - | - | 4,521 | 6,697 |
| Purchases and issuances | - | - | - | 3,682 | - |
| Sales and settlements | (1,118) | - | - | (6,520) | - |
| Transfers into Level 3 | 6,003 | - | - | - | - |
| Transfers out of Level 3 | - | - | - | (315) | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 25,248 | \$ - | \$ - | \$ 117,765 | \$ (35,947) |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 3,681 | \$ - | \$ - | \$ 1,004 | \$ 6,697 |

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

Level 3 Assets and Liabilities - Six Months Ended June 30, 2011

| <i>(U.S. dollars in thousands)</i> | 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) | (279) | - | - | (678) | (1,071) |
| Movement in unrealized gains (losses) | 195 | (50) | (16) | 514 | 36,417 |
| Purchases and issuances | 6,877 | - | - | 3,155 | 2,379 |
| Sales and settlements | (10,049) | (286) | (374) | (51) | (33,944) |
| Transfers into Level 3 | - | - | - | - | 1,886 |
| Transfers out of Level 3 | (28,824) | (14,534) | (1,380) | - | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 4,786 | \$ 15,385 | \$ 3,194 | \$ 4,563 | \$ 727,239 |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 6 | \$ (50) | \$ (16) | \$ (152) | \$ 33,777 |

Level 3 Assets and Liabilities - Six Months Ended June 30, 2011

| <i>(U.S. dollars in thousands)</i> | 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) | (317) | - | - | 12,155 | - |
| Movement in unrealized gains (losses) | 6,860 | - | - | 7,492 | (10,276) |
| Purchases and issuances | - | - | - | 8,115 | - |
| Sales and settlements | (9,114) | - | - | (46,939) | (174) |
| Transfers into Level 3 | - | - | - | - | - |
| Transfers out of Level 3 | (5,031) | (3,667) | - | - | - |
| Fixed maturities to short-term investments classification change | - | - | - | - | - |
| Balance, end of period | \$ 17,048 | \$ - | \$ - | \$ 114,540 | \$ (49,645) |
| Movement in total gains (losses) above relating to instruments still held at the reporting date | \$ 6,193 | \$ - | \$ - | \$ 17,337 | \$ (10,276) |

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(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 where the Company is not deemed to have significant influence over the investee. 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 Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

(e) Derivative instruments

Derivative instruments recorded within Other liabilities and classified within Level 3 include credit derivatives sold providing 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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(f) 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 June 30, 2012 and December 31, 2011. All of these fair values 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.

| (U.S. dollars in thousands) | June 30, 2012 | | December 31, 2011 | |
|---|---------------------|---------------------|---------------------|---------------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Fixed maturities, held to maturity | \$ 2,716,357 | \$ 3,006,992 | \$ 2,668,978 | \$ 2,895,668 |
| Other investments - structured transactions | 314,015 | 289,874 | 323,705 | 297,124 |
| Financial Assets | \$ 3,030,372 | \$ 3,296,866 | \$ 2,992,683 | \$ 3,192,792 |
| Deposit liabilities | \$ 1,600,595 | \$ 1,876,742 | \$ 1,608,108 | \$ 1,809,812 |
| Notes payable and debt | 1,673,921 | 1,820,193 | 2,275,327 | 2,340,148 |
| Financial Liabilities | \$ 3,274,516 | \$ 3,696,935 | \$ 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 139.7 basis points at June 30, 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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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.

Three Months Ended June 30, 2012

(U.S. dollars in thousands, except ratios)

| | Insurance | Reinsurance | Total P&C | Life Operations | Total |
|--|--------------|-------------|--------------|-----------------|--------------|
| Gross premiums written | \$ 1,311,034 | \$ 452,417 | \$ 1,763,451 | \$ 92,904 | \$ 1,856,355 |
| Net premiums written | 944,267 | 403,011 | 1,347,278 | 85,623 | 1,432,901 |
| Net premiums earned | 959,294 | 441,678 | 1,400,972 | 85,623 | 1,486,595 |
| Net losses and loss expenses | (635,284) | (191,071) | (826,355) | (131,150) | (957,505) |
| Acquisition costs | (123,284) | (87,723) | (211,007) | (7,930) | (218,937) |
| Operating expenses (1) | (192,247) | (41,991) | (234,238) | (2,829) | (237,067) |
| Underwriting profit (loss) | \$ 8,479 | \$ 120,893 | \$ 129,372 | \$ (56,286) | \$ 73,086 |
| Net investment income | - | - | 170,581 | 74,645 | 245,226 |
| Net results from structured products (2) | 9,047 | (22,913) | (13,866) | - | (13,866) |
| Net fee income and other (3) | (1,847) | 990 | (857) | 42 | (815) |
| Net realized gains (losses) on investments | | | (2,154) | (10,239) | (12,393) |

Contribution from P&C and Life Operations

\$ 283,076 \$ 8,162 \$ 291,238

Corporate & other:

| | | | | | |
|--|--|--|--|--|----------|
| Net realized & unrealized gains (losses) on derivative instruments | | | | | (4,300) |
| Net income (loss) from investment fund affiliates and operating affiliates (4) | | | | | 25,658 |
| Exchange gains (losses) | | | | | 17,976 |
| Corporate operating expenses | | | | | (50,061) |
| Interest expense (5) | | | | | (26,089) |
| Non-controlling interests | | | | | (3,454) |
| Income tax | | | | | (29,812) |

Net income (loss) attributable to XL Group plc

\$ 221,156

Ratios P&C operations: (6)

| | | | |
|-----------------------------|-------|-------|-------|
| Loss and loss expense ratio | 66.2% | 43.3% | 59.0% |
| Underwriting expense ratio | 32.9% | 29.3% | 31.8% |
| Combined ratio | 99.1% | 72.6% | 90.8% |

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- (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 \$17.4 million and \$31.3 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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Three Months Ended June 30,
2011(U.S. dollars in thousands,
except ratios)

| | Insurance | Reinsurance | Total P&C | Life Operations | Total |
|--|--------------|-------------|--------------|--------------------|--------------|
| Gross premiums written | \$ 1,290,030 | \$ 472,413 | \$ 1,762,443 | \$ 100,281 | \$ 1,862,724 |
| Net premiums written | 893,191 | 412,868 | 1,306,059 | 92,194 | 1,398,253 |
| Net premiums earned | 907,443 | 398,682 | 1,306,125 | 92,214 | 1,398,339 |
| Net losses and loss expenses | (608,182) | (215,402) | (823,584) | (137,416) | (961,000) |
| Acquisition costs | (113,883) | (91,448) | (205,331) | (9,768) | (215,099) |
| Operating expenses (1) | (166,608) | (43,553) | (210,161) | (2,723) | (212,884) |
| Underwriting profit (loss) | \$ 18,770 | \$ 48,279 | \$ 67,049 | \$ (57,693) | \$ 9,356 |
| Net investment income | - | - | 196,053 | 82,057 | 278,110 |
| Net results from structured products (2) | 2,690 | 2,226 | 4,916 | - | 4,916 |
| Net fee income and other (3) | (3,218) | (9) | (3,227) | 96 | (3,131) |
| Net realized gains (losses) on investments | | | (10,248) | 704 | (9,544) |
| Contribution from P&C and Life Operations | | | \$ 254,543 | \$ 25,164 | \$ 279,707 |
| Corporate & other: | | | | | |
| Net realized & unrealized gains (losses) on derivative instruments | | | | | (10,950) |
| Net income (loss) from investment fund affiliates and operating affiliates (4) | | | | | 56,501 |
| Exchange gains (losses) | | | | | 8,498 |
| Corporate operating expenses | | | | | (39,566) |
| Interest expense (5) | | | | | (41,599) |
| Non-controlling interests | | | | | (2,102) |
| Income tax | | | | | (24,826) |
| Net income (loss) attributable to XL Group plc | | | | | \$ 225,663 |

Ratios P&C operations: (6)

| | | | |
|-----------------------------|-------|-------|-------|
| Loss and loss expense ratio | 67.0% | 54.0% | 63.1% |
| Underwriting expense ratio | 30.9% | 33.9% | 31.8% |
| Combined ratio | 97.9% | 87.9% | 94.9% |

(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 \$18.4 million and \$13.5 million, respectively.

(3)

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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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2012

(U.S. dollars in thousands, except ratios)

| | Insurance | Reinsurance | Total P&C | Life Operations | Total |
|--|--------------|--------------|--------------|-----------------|--------------|
| Gross premiums written | \$ 2,647,668 | \$ 1,432,767 | \$ 4,080,435 | \$ 179,587 | \$ 4,260,022 |
| Net premiums written | 1,980,793 | 1,329,713 | 3,310,506 | 164,119 | 3,474,625 |
| Net premiums earned | 1,893,350 | 865,520 | 2,758,870 | 164,143 | 2,923,013 |
| Net losses and loss expenses | (1,266,969) | (413,451) | (1,680,420) | (252,457) | (1,932,877) |
| Acquisition costs | (251,540) | (175,967) | (427,507) | (15,581) | (443,088) |
| Operating expenses (1) | (377,593) | (80,738) | (458,331) | (5,436) | (463,767) |
| Underwriting profit (loss) | \$ (2,752) | \$ 195,364 | \$ 192,612 | \$ (109,331) | \$ 83,281 |
| Net investment income | - | - | 343,549 | 149,671 | 493,220 |
| Net results from structured products (2) | 11,866 | (20,415) | (8,549) | - | (8,549) |
| Net fee income and other (3) | (3,867) | 1,323 | (2,544) | 90 | (2,454) |
| Net realized gains (losses) on investments | | | 22,813 | (14,403) | 8,410 |
| Contribution from P&C and Life Operations | | | \$ 547,881 | \$ 26,027 | \$ 573,908 |
| Corporate & other: | | | | | |
| Net realized & unrealized gains (losses) on derivative instruments | | | | | (3,598) |
| Net income (loss) from investment fund affiliates and operating affiliates (4) | | | | | 61,319 |
| Exchange gains (losses) | | | | | 5,258 |
| Corporate operating expenses | | | | | (94,321) |
| Interest expense (5) | | | | | (53,409) |
| Non-controlling interests | | | | | (40,011) |
| Income tax | | | | | (51,362) |
| Net income (loss) attributable to XL Group plc | | | | | \$ 397,784 |

Ratios P&C operations: (6)

| | | | |
|-----------------------------|--------|-------|-------|
| Loss and loss expense ratio | 66.9% | 47.8% | 60.9% |
| Underwriting expense ratio | 33.2% | 29.6% | 32.1% |
| Combined ratio | 100.1% | 77.4% | 93.0% |

(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 \$34.7 million and \$43.2 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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2011

(U.S. dollars in thousands, except ratios)

| | Insurance | Reinsurance | Total P&C | Life Operations | Total |
|--|--------------|--------------|--------------|-----------------|--------------|
| Gross premiums written | \$ 2,512,379 | \$ 1,349,184 | \$ 3,861,563 | \$ 197,940 | \$ 4,059,503 |
| Net premiums written | 1,812,181 | 1,208,160 | 3,020,341 | 181,866 | 3,202,207 |
| Net premiums earned | 1,783,363 | 794,458 | 2,577,821 | 181,901 | 2,759,722 |
| Net losses and loss expenses | (1,396,695) | (635,754) | (2,032,449) | (270,647) | (2,303,096) |
| Acquisition costs | (221,527) | (164,974) | (386,501) | (17,088) | (403,589) |
| Operating expenses (1) | (330,703) | (89,183) | (419,886) | (4,889) | (424,775) |
| Underwriting profit (loss) | \$ (165,562) | \$ (95,453) | \$ (261,015) | \$ (110,723) | \$ (371,738) |
| Net investment income | - | - | 379,618 | 159,033 | 538,651 |
| Net results from structured products (2) | 5,950 | 6,440 | 12,390 | - | 12,390 |
| Net fee income and other (3) | (9,130) | 1,385 | (7,745) | 137 | (7,608) |
| Net realized gains (losses) on investments | | | (37,134) | (38,847) | (75,981) |
| Contribution from P&C and Life Operations | | | \$ 86,114 | \$ 9,600 | \$ 95,714 |
| Corporate & other: | | | | | |
| Net realized & unrealized gains (losses) on derivative instruments | | | | | (7,383) |
| Net income (loss) from investment fund affiliates and operating affiliates (4) | | | | | 97,287 |
| Exchange gains (losses) | | | | | (1,016) |
| Corporate operating expenses | | | | | (75,258) |
| Interest expense (5) | | | | | (83,498) |
| Non-controlling interests | | | | | (35,438) |
| Income tax | | | | | 7,971 |
| Net income (loss) attributable to XL Group plc | | | | | \$ (1,621) |

Ratios P&C operations: (6)

| | | | |
|-----------------------------|--------|--------|--------|
| Loss and loss expense ratio | 78.3% | 80.0% | 78.8% |
| Underwriting expense ratio | 31.0% | 32.0% | 31.3% |
| Combined ratio | 109.3% | 112.0% | 110.1% |

(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 \$38.1 million and \$25.7 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)

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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 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

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

Three Months Ended June 30, 2012

(U.S. dollars in thousands)

| | Insurance | Reinsurance | Life Operations | Total |
|--|-------------------|-------------------|------------------|---------------------|
| P&C Operations: | | | | |
| Casualty - professional lines | \$ 330,876 | \$ 53,303 | \$ - | \$ 384,179 |
| Casualty - other lines | 167,562 | 76,842 | - | 244,404 |
| Property catastrophe | - | 113,221 | - | 113,221 |
| Other property | 124,893 | 145,025 | - | 269,918 |
| Marine, energy, aviation and satellite | 143,981 | 35,627 | - | 179,608 |
| Other specialty lines (1) | 190,169 | - | - | 190,169 |
| Other (2) | 1,813 | 17,660 | - | 19,473 |
| Total P&C Operations | \$ 959,294 | \$ 441,678 | \$ - | \$ 1,400,972 |
| Life Operations: | | | | |
| Annuity | \$ - | \$ - | \$ 31,243 | \$ 31,243 |
| Other Life | - | - | 54,380 | 54,380 |
| Total Life Operations | \$ - | \$ - | \$ 85,623 | \$ 85,623 |
| Total | \$ 959,294 | \$ 441,678 | \$ 85,623 | \$ 1,486,595 |

Three Months Ended June 30, 2011

(U.S. dollars in thousands)

| | Insurance | Reinsurance | Life Operations | Total |
|--|-------------------|-------------------|------------------|---------------------|
| P&C Operations: | | | | |
| Casualty - professional lines | \$ 322,654 | \$ 51,915 | \$ - | \$ 374,569 |
| Casualty - other lines | 172,246 | 68,920 | - | 241,166 |
| Property catastrophe | - | 94,363 | - | 94,363 |
| Other property | 117,088 | 135,255 | - | 252,343 |
| Marine, energy, aviation and satellite | 128,358 | 30,436 | - | 158,794 |
| Other specialty lines (1) | 165,027 | - | - | 165,027 |
| Other (2) | 2,070 | 17,793 | - | 19,863 |
| Total P&C Operations | \$ 907,443 | \$ 398,682 | \$ - | \$ 1,306,125 |
| Life Operations: | | | | |
| Annuity | \$ - | \$ - | \$ 33,968 | \$ 33,968 |
| Other Life | - | - | 58,246 | 58,246 |
| Total Life Operations | \$ - | \$ - | \$ 92,214 | \$ 92,214 |
| Total | \$ 907,443 | \$ 398,682 | \$ 92,214 | \$ 1,398,339 |

(1) Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, fine art and specie, middle markets, political risk and trade credit, product recall, surety, inland marine and surplus lines.

(2) Other includes whole account contracts, structured indemnity, internal reinsurance and other lines.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2012

(U.S. dollars in thousands)

| | Insurance | Reinsurance | Life Operations | Total |
|--|---------------------|-------------------|--------------------|---------------------|
| P&C Operations: | | | | |
| Casualty - professional lines | \$ 654,696 | \$ 108,209 | \$ - | \$ 762,905 |
| Casualty - other lines | 334,920 | 150,080 | - | 485,000 |
| Property catastrophe | - | 216,146 | - | 216,146 |
| Other property | 258,312 | 280,769 | - | 539,081 |
| Marine, energy, aviation and satellite | 264,081 | 71,371 | - | 335,452 |
| Other specialty lines (1) | 374,203 | - | - | 374,203 |
| Other (2) | 7,138 | 38,945 | - | 46,083 |
| Total P&C Operations | \$ 1,893,350 | \$ 865,520 | \$ - | \$ 2,758,870 |
| Life Operations: | | | | |
| Annuity | \$ - | \$ - | \$ 62,700 | \$ 62,700 |
| Other Life | - | - | 101,443 | 101,443 |
| Total P&C Operations | \$ - | \$ - | \$ 164,143 | \$ 164,143 |
| Total | \$ 1,893,350 | \$ 865,520 | \$ 164,143 | \$ 2,923,013 |

Six Months Ended June 30, 2011

(U.S. dollars in thousands)

| | Insurance | Reinsurance | Life Operations | Total |
|--|---------------------|-------------------|--------------------|---------------------|
| P&C Operations: | | | | |
| Casualty - professional lines | \$ 638,297 | \$ 105,632 | \$ - | \$ 743,929 |
| Casualty - other lines | 328,950 | 119,963 | - | 448,913 |
| Property catastrophe | - | 188,927 | - | 188,927 |
| Other property | 224,009 | 271,498 | - | 495,507 |
| Marine, energy, aviation and satellite | 253,893 | 68,864 | - | 322,757 |
| Other specialty lines (1) | 333,693 | - | - | 333,693 |
| Other (2) | 4,521 | 39,574 | - | 44,095 |
| Total P&C Operations | \$ 1,783,363 | \$ 794,458 | \$ - | \$ 2,577,821 |
| Life Operations: | | | | |
| Annuity | \$ - | \$ - | \$ 66,891 | \$ 66,891 |
| Other Life | - | - | 115,010 | 115,010 |
| Total P&C Operations | \$ - | \$ - | \$ 181,901 | \$ 181,901 |
| Total | \$ 1,783,363 | \$ 794,458 | \$ 181,901 | \$ 2,759,722 |

(1) Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, fine art and specie, middle markets, political risk and trade credit, product recall, surety, inland marine and surplus lines.

(2) Other includes whole account contracts, structured indemnity, internal reinsurance and other lines.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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, other-than-temporary impairments (OTTI) recorded in accumulated other comprehensive income (AOCI) of the Company's available for sale (AFS) and held to maturity (HTM) investments at June 30, 2012 and December 31, 2011 were as follows:

| June 30, 2012 (U.S. dollars in thousands) | Cost or Amortized Cost | Gross Unrealized Gains | Included in AOCI | | Fair Value |
|---|------------------------------|------------------------------|---|--|----------------------|
| | | | Related to Changes in Estimated Fair Value | Gross Unrealized Losses Non-credit Related OTTI | |
| Fixed maturities - AFS | | | | | |
| U.S. Government and Government-Related/Supported (1) | \$ 1,971,384 | \$ 133,040 | \$ (2,799) | \$ - | \$ 2,101,625 |
| Corporate (2) (3) (4) | 9,297,657 | 597,211 | (157,659) | (16,056) | 9,721,153 |
| RMBS Agency | 5,001,023 | 203,766 | (2,476) | - | 5,202,313 |
| RMBS Non-Agency | 728,309 | 21,822 | (52,341) | (113,247) | 584,543 |
| CMBS | 842,802 | 66,058 | (487) | (3,581) | 904,792 |
| CDO | 796,018 | 8,095 | (149,211) | (4,884) | 650,018 |
| Other asset-backed securities (2) | 1,392,065 | 44,974 | (19,486) | (9,815) | 1,407,738 |
| U.S. States and political subdivisions of the States | 1,640,991 | 125,221 | (1,781) | - | 1,764,431 |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (1) | 3,772,530 | 148,569 | (14,910) | - | 3,906,189 |
| Total fixed maturities - AFS | \$ 25,442,779 | \$ 1,348,756 | \$ (401,150) | \$ (147,583) | \$ 26,242,802 |
| Total short-term investments (1) | \$ 227,321 | \$ 293 | \$ (234) | \$ - | \$ 227,380 |
| Total equity securities | \$ 553,715 | \$ 3,212 | \$ (27,871) | \$ - | \$ 529,056 |
| Total investments - AFS | \$ 26,223,815 | \$ 1,352,261 | \$ (429,255) | \$ (147,583) | \$ 26,999,238 |
| Fixed maturities - HTM | | | | | |
| U.S. Government and Government-Related/Supported (1) | \$ 10,458 | \$ 1,753 | \$ - | \$ - | \$ 12,211 |
| Corporate (2) | 1,387,033 | 131,267 | (8,847) | - | 1,509,453 |
| RMBS Non-Agency | 81,028 | 6,077 | (15) | - | 87,090 |
| CMBS | 12,546 | 1,667 | - | - | 14,213 |
| Other asset-backed securities (2) | 217,347 | 20,156 | (464) | - | 237,039 |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (1) | 1,007,945 | 142,215 | (3,174) | - | 1,146,986 |
| Total investments - HTM | \$ 2,716,357 | \$ 303,135 | \$ (12,500) | \$ - | \$ 3,006,992 |

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- (1) 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 \$2,012.4 million and fair value of \$2,066.0 million and U.S. Agencies with an amortized cost of \$455.0 million and fair value of \$500.5 million.
- (2) At June 30, 2012, Covered Bonds within Fixed maturities AFS with an amortized cost of \$478.1 million and a fair value of \$500.5 million and Covered Bonds within Fixed maturities HTM with an amortized cost of \$8.1 million and a fair value of \$7.8 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.
- (3) 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 \$186.1 million and an amortized cost of \$199.1 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.
- (4) 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 \$346.2 million and an amortized cost of \$420.3 million at June 30, 2012.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

| December 31, 2011 (U.S. dollars in thousands) | Included in AOCI | | | | |
|---|------------------------------|------------------------------|-------------------------------|---------------------|----------------------|
| | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | | Fair Value |
| Related to Changes in Estimated Fair Value | | | Non-credit Related OTTI | | |
| Fixed maturities - AFS | | | | | |
| U.S. Government and Government-Related/Supported (1) | \$ 1,864,354 | \$ 130,874 | \$ (4,245) | \$ - | \$ 1,990,983 |
| Corporate (2) (3) (4) | 9,866,677 | 527,192 | (233,581) | (51,666) | 10,108,622 |
| RMBS Agency | 5,189,473 | 193,782 | (3,849) | - | 5,379,406 |
| RMBS Non-Agency | 851,557 | 19,667 | (112,867) | (116,542) | 641,815 |
| CMBS | 927,684 | 56,704 | (2,405) | (7,148) | 974,835 |
| CDO | 843,553 | 6,624 | (186,578) | (4,997) | 658,602 |
| Other asset-backed securities (2) | 1,341,309 | 30,731 | (25,486) | (6,305) | 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 (1) | 3,188,535 | 127,439 | (17,839) | - | 3,298,135 |
| Total fixed maturities - AFS | \$ 25,771,715 | \$ 1,194,038 | \$ (589,070) | \$ (186,658) | \$ 26,190,025 |
| Total short-term investments (1) | \$ 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 | \$ (630,339) | \$ (186,658) | \$ 27,017,285 |
| Fixed maturities - HTM | | | | | |
| U.S. Government and Government-Related/Supported (2) | \$ 10,399 | \$ 1,510 | \$ - | \$ - | \$ 11,909 |
| Corporate (2) | 1,290,209 | 91,313 | (14,433) | - | 1,367,089 |
| RMBS Non-Agency | 80,955 | 6,520 | (32) | - | 87,443 |
| Other asset-backed securities (2) | 288,741 | 20,875 | (320) | - | 309,296 |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (1) | 998,674 | 127,227 | (5,950) | - | 1,119,951 |
| Total investments - HTM | \$ 2,668,978 | \$ 247,445 | \$ (20,735) | \$ - | \$ 2,895,688 |

- (1) 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.
- (2) 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.
- (3)

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- 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.
- (4) 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.

At June 30, 2012 and December 31, 2011, approximately 2.7% and 2.4%, respectively, of the Company's fixed income investment portfolio at fair value was invested in securities that were below investment grade or not rated. Approximately 34.2% and 31.4% of the gross unrealized losses in the Company's fixed income securities portfolio at June 30, 2012 and December 31, 2011, respectively, related to securities that were below investment grade or not rated.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

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 will be 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.

During 2009 and 2010, the Company elected to hold certain fixed income securities to maturity. Consistent with this intention, the Company reclassified these securities from AFS to HTM in the consolidated financial statements. As a result of this classification, these fixed income securities are reflected in the HTM portfolio and recorded at amortized cost in the consolidated balance sheets and not fair value. Additional securities purchased that have already been designated as HTM are included as part of the HTM portfolio. The HTM portfolio is comprised of long duration non-U.S. securities, which are Euro and U.K. sterling denominated. The Company believes this HTM strategy is achievable due to the relatively stable and predictable cash flows of the Company's long-term liabilities within its Life operations, along with its ability to substitute other assets at a future date in the event that liquidity was required due to changes in expected cash flows or other transactions entered into related to the long-term liabilities supported by the HTM portfolio. At June 30, 2012, 97.3% of the HTM securities were rated A or higher. The unrealized appreciation at the dates of these reclassifications continues to be reported as a separate component of shareholders' equity and is being amortized over the remaining lives of the securities as an adjustment to yield in a manner consistent with the amortization of any premium or discount. At the time of the reclassifications, the unrealized U.S. dollar equivalent appreciation related to securities reclassified was \$131.5 million in total, with \$105.5 million and \$108.4 million unamortized at June 30, 2012 and December 31, 2011, respectively.

Covered Bonds were included within Corporate securities prior to January 1, 2012. They are now 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.

Contractual Maturities Summary

The contractual maturities of AFS and HTM fixed income securities at June 30, 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.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

| | June 30, 2012 (1) | | December 31, 2011 (1) | |
|--|----------------------|----------------------|-----------------------|----------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| <i>(U.S. dollars in thousands)</i> | | | | |
| Fixed maturities - AFS | | | | |
| Due less than one year | \$ 1,983,583 | \$ 1,999,239 | \$ 2,004,395 | \$ 2,020,361 |
| Due after 1 through 5 years | 7,976,631 | 8,243,009 | 7,736,717 | 7,909,354 |
| Due after 5 through 10 years | 3,401,824 | 3,610,915 | 3,619,141 | 3,777,073 |
| Due after 10 years | 3,320,524 | 3,640,235 | 3,257,886 | 3,488,330 |
| | \$ 16,682,562 | \$ 17,493,398 | \$ 16,618,139 | \$ 17,195,118 |
| RMBS Agency | 5,001,023 | 5,202,313 | 5,189,473 | 5,379,406 |
| RMBS Non-Agency | 728,309 | 584,543 | 851,557 | 641,815 |
| CMBS | 842,802 | 904,792 | 927,684 | 974,835 |
| CDO | 796,018 | 650,018 | 843,553 | 658,602 |
| Other asset-backed securities | 1,392,065 | 1,407,738 | 1,341,309 | 1,340,249 |
| Total mortgage and asset-backed securities | \$ 8,760,217 | \$ 8,749,404 | \$ 9,153,576 | \$ 8,994,907 |
| Total fixed maturities - AFS | \$ 25,442,779 | \$ 26,242,802 | \$ 25,771,715 | \$ 26,190,025 |
| Fixed maturities - HTM | | | | |
| Due less than one year | \$ 30,847 | \$ 31,138 | \$ 11,796 | \$ 11,768 |
| Due after 1 through 5 years | 165,678 | 172,104 | 122,091 | 123,871 |
| Due after 5 through 10 years | 365,103 | 386,251 | 393,865 | 402,424 |
| Due after 10 years | 1,843,808 | 2,079,157 | 1,771,530 | 1,960,886 |
| | \$ 2,405,436 | \$ 2,668,650 | \$ 2,299,282 | \$ 2,498,949 |
| RMBS Non-Agency | 81,028 | 87,090 | 80,955 | 87,443 |
| CMBS | 12,546 | 14,213 | - | - |
| Other asset-backed securities | 217,347 | 237,039 | 288,741 | 309,296 |
| Total mortgage and asset-backed securities | \$ 310,921 | \$ 338,342 | \$ 369,696 | \$ 396,739 |
| Total fixed maturities - HTM | \$ 2,716,357 | \$ 3,006,992 | \$ 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 \$346.2 million and \$386.1 million at June 30, 2012 and December 31, 2011, respectively. These securities are reflected in the table based on their call date and have net unrealized losses of \$74.7 million and \$108.8 million at June 30, 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 in

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earnings (credit loss impairments) 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.

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5. Investments

Factors considered 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 June 30, 2012 and December 31, 2011, the Company had \$17.5 billion and \$17.2 billion in pledged assets, respectively.

(b) Gross Unrealized Losses

The following is an analysis of how long the AFS and HTM securities at June 30, 2012 and December 31, 2011 had been in a continual unrealized loss position:

| | Less than 12 months | | Equal to or greater than 12 months | |
|---|---------------------|-------------------------|------------------------------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| June 30, 2012 | | | | |
| <i>(U.S. dollars in thousands)</i> | | | | |
| Fixed maturities and short-term investments - AFS | | | | |
| U.S. Government and Government-Related/Supported | \$ 311,939 | \$ (1,902) | \$ 10,518 | \$ (1,014) |
| Corporate (1) (2) (3) | 422,004 | (12,834) | 903,366 | (160,988) |
| RMBS Agency | 100,286 | (1,496) | 14,405 | (980) |
| RMBS Non-Agency | 29,190 | (1,745) | 462,704 | (163,843) |
| CMBS | 13,945 | (281) | 30,996 | (3,787) |
| CDO | 13,727 | (2,651) | 627,018 | (151,444) |
| Other asset-backed securities (3) | 97,511 | (972) | 139,949 | (28,329) |
| U.S. States and political subdivisions of the States | 10,227 | (121) | 16,029 | (1,660) |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | 296,340 | (4,296) | 163,791 | (10,624) |
| Total fixed maturities and short-term investments - AFS | \$ 1,295,169 | \$ (26,298) | \$ 2,368,776 | \$ (522,669) |
| Total equity securities (4) | \$ 422,204 | \$ (27,871) | \$ - | \$ - |
| Fixed maturities -HTM | | | | |
| Corporate (3) | \$ 23,418 | \$ (374) | \$ 49,617 | \$ (8,473) |
| RMBS Non-Agency | 4,996 | (15) | - | - |
| Other asset-backed securities (3) | 8,972 | (464) | - | - |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | 20,173 | (71) | 8,725 | (3,103) |
| Total fixed maturities - HTM | \$ 57,559 | \$ (924) | \$ 58,342 | \$ (11,576) |

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- (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 \$186.1 million and an amortized cost of \$199.1 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 \$346.2 million and an amortized cost of \$420.3 million at June 30, 2012.
- (3) Covered Bonds within Fixed maturities and short-term investments AFS with a fair value of \$34.3 million and Covered Bonds within Fixed Maturities HTM with a fair value of \$8.1 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 \$95.8 million and an amortized cost of \$100.0 million at June 30, 2012.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

| December 31, 2011 (U.S. dollars in thousands) | Less than 12 months | | Equal to or greater than 12 months | |
|---|---------------------|-------------------------|------------------------------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed maturities and short-term investments - AFS | | | | |
| U.S. Government and Government-Related/Supported Corporate (1) (2) (3) | \$ 289,260 | \$ (332) | \$ 43,622 | \$ (3,984) |
| RMBS Agency | 1,078,664 | (42,151) | 1,185,535 | (243,683) |
| RMBS Non-Agency | 310,318 | (849) | 36,960 | (3,000) |
| CMBS | 106,294 | (31,714) | 449,138 | (197,695) |
| CDO | 69,109 | (2,716) | 39,444 | (6,837) |
| Other asset-backed securities (3) | 3,357 | (2,261) | 636,362 | (189,456) |
| U.S. States and political subdivisions of the States | 227,098 | (3,324) | 161,312 | (28,467) |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | 25,309 | (199) | 27,646 | (2,021) |
| | 265,766 | (4,707) | 202,890 | (13,166) |
| Total fixed maturities and short-term investments - AFS | \$ 2,375,175 | \$ (88,253) | \$ 2,782,909 | \$ (688,309) |
| Total equity securities (4) | \$ 361,585 | \$ (40,435) | \$ - | \$ - |
| Fixed maturities -HTM | | | | |
| Corporate (3) | \$ 147,836 | \$ (7,770) | \$ 62,343 | \$ (6,663) |
| RMBS Non-Agency | 9,372 | (32) | - | - |
| Other asset-backed securities (3) | 7,743 | (314) | 1,106 | (6) |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported | 79,242 | (1,206) | 18,330 | (4,744) |
| Total fixed maturities - HTM | \$ 244,193 | \$ (9,322) | \$ 81,779 | \$ (11,413) |

- (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 \$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.
- (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 \$386.1 million and an amortized cost of \$494.9 million at December 31, 2011.
- (3) Covered Bonds within Fixed maturities and short-term investments - AFS with a fair value of \$44.7 million and Covered Bonds within Fixed Maturities HTM with a fair value of \$7.7 million have been included within Other asset-backed securities to align the Company's classification to market indices and to conform to current period presentation. 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 \$91.6 million and an amortized cost of \$100.0 million at December 31, 2011.

The Company had gross unrealized losses totaling \$576.8 million on 1,308 securities out of a total of 7,156 held at June 30, 2012 in its AFS portfolio and \$12.5 million on 15 securities out of a total of 208 held in its HTM portfolio, which it considers 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 to determine the severity of these impairments and whether they should be considered other-than-temporary. Management believes 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.

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Management, in its assessment of whether securities in a gross unrealized loss position are temporarily impaired, considers the significance of the impairments. At June 30, 2012, the Company had structured credit securities with gross unrealized losses of \$55.2 million, which had a fair value of \$26.3 million, and a cumulative fair value decline of greater than 50% of amortized cost. All of these securities are mortgage and asset-backed securities. These greater than 50% impaired securities include gross unrealized losses of \$32.7 million on non-Agency RMBS, \$21.7 million on Core CDOs and \$0.8 million of CMBS holdings.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

(c) Net Realized Gains (Losses)

The following represents an analysis of net realized gains (losses) on investments:

| Net Realized Gains (Losses) on Investments (U.S. dollars in thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------------|------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| Gross realized gains | \$ 53,732 | \$ 61,037 | \$ 120,621 | \$ 88,179 |
| Gross realized losses on investments sold | (37,932) | (43,405) | (63,053) | (99,539) |
| OTTI on investments, net of amounts transferred to other comprehensive income | (28,193) | (27,176) | (49,158) | (64,621) |
| Net realized gains (losses) on investments | \$ (12,393) | \$ (9,544) | \$ 8,410 | \$ (75,981) |

The significant components of the net impairment charges of \$28.2 million for the three months ended June 30, 2012 were:

- § \$14.3 million for structured securities where the Company 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.
- § \$10.2 million related to medium term notes backed primarily by European investment grade credit. On certain notes, management concluded that future returns on the underlying assets were not sufficient to support the previously reported amortized cost. The Company also adjusted the estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.
- § \$2.2 million related to currency losses primarily arising on U.K. sterling denominated securities held in U.S. dollar portfolios.
- § \$1.5 million related to equities as the holding was more than 50% impaired.

The following table sets forth the amount of credit loss impairments on fixed income securities held by the Company as of the dates indicated, for which a portion of the OTTI loss was recognized in OCI, and the corresponding changes in such amounts.

| Credit Loss Impairments (U.S. dollars in thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Opening balance | \$ 314,805 | \$ 330,170 | \$ 333,379 | \$ 426,372 |
| Credit loss impairment recognized in the current period on securities not previously impaired | 4,043 | 11,333 | 5,878 | 15,906 |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (40,797) | (38,316) | (59,737) | (164,027) |
| Credit loss impairments previously recognized on securities impaired to fair value during the period | - | - | (16,384) | - |
| Additional credit loss impairments recognized in the current period on securities previously impaired | 21,952 | 13,339 | 36,882 | 38,798 |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | (283) | (682) | (298) | (1,205) |

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| | | | | | | | | |
|---------------------|----|---------|----|---------|----|---------|----|---------|
| Balance at June 30, | \$ | 299,720 | \$ | 315,844 | \$ | 299,720 | \$ | 315,844 |
|---------------------|----|---------|----|---------|----|---------|----|---------|

During the three months ended June 30, 2012 and 2011, the \$40.8 million and \$38.3 million, respectively, of credit loss impairments previously recognized on securities that matured, or were paid down, prepaid or sold, includes \$21.9 million and \$20.9 million, respectively, of non-Agency RMBS.

During the six months ended June 30, 2012 and 2011, the \$59.7 million and \$164.0 million, respectively, of credit loss impairments previously recognized on securities that matured, or were paid down, prepaid or sold, includes \$31.8 million and \$112.6 million, respectively, of non-Agency RMBS.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

(d) Other Investments

Structured Transactions - Project Finance Loans

The Company historically participated in structured transactions in project finance related areas under which the Company provided a cash loan supporting project finance transactions. These transactions are accounted for in accordance with guidance governing accounting by certain entities (including entities with trade receivables) that lend to or finance the activities of others under which the loans are considered held for investment as the Company has the intent and ability to hold for the foreseeable future or until maturity or payoff. Accordingly, these funded loan participations are reported in the balance sheet at outstanding principal adjusted for any allowance for loan losses as considered necessary by management.

The following table shows a summary of the structured project finance loans at June 30, 2012 and December 31, 2011:

| Project Finance Loans (U.S. dollars in thousands) | June 30, 2012 | December 31, 2011 |
|--|------------------|-------------------------|
| Aggregate loan value | \$ 36,536 | \$ 49,650 |
| Aggregate loan net carrying value | \$ 30,953 | \$ 40,483 |
| Opening allowance for loan losses | \$ (9,167) | \$ (9,167) |
| Amounts charged off during the period | 3,584 | - |
| Closing allowance for loan losses | \$ (5,583) | \$ (9,167) |
| Number of individual loan participations | 4 | 6 |
| Number of individual loan participations relating to the allowance for loan losses | 1 | 2 |
| Weighted average contractual term to maturity | 1.1 years | 2.1 years |
| Weighted average credit rating | BB | BB- |
| Range of individual credit ratings | BB+ to BB- | BB+ to CCC |

Surveillance procedures are conducted over each structured project finance loan on an ongoing basis with current expectations of future collections of contractual interest and principal used to determine whether any allowance for loan losses may be required at each period end. If it is determined that a future credit loss on a specific contract is reasonably possible and an amount can be estimated, an allowance is recorded. The contractual receivable is only charged off when the final outcome is known and the Company has exhausted all commercial efforts to try and collect any outstanding balances.

During the six months ended June 30, 2012 and the year ended December 31, 2011, management conducted separate reviews of each loan participation and determined loss allowance estimates, as shown in the table above, using a recovery value concept. Management considers recovery value to be the percentage of all future contractual interest and principal that the Company expects to receive from the borrower through any combination of regular debt service, other payments, salvage and recovery. The allowances for loan losses are made when it is probable that a loss will be incurred based upon current information received from the borrower.

Investment Fund Consolidation

During May 2012, the Company invested \$25.0 million to obtain a 94% interest in Five Oaks Investment Corp. (Five Oaks), a newly formed private investment company. Five Oaks is a mortgage real estate investment trust that is expected to follow an investment strategy balancing a leveraged portfolio of Agency RMBS with an unlevered or moderately levered portfolio of non-Agency RMBS. Five Oaks may enter into repurchase agreements to acquire investment leverage up to a maximum of \$79.5 million. At June 30, 2012, the Company has consolidated Five Oaks resulting in the recording within its balance sheet of: RMBS securities at their fair value of \$80.7 million (amortized cost: \$80.6 million) within Fixed maturities, \$14.9 million of Cash and cash equivalents, \$69.1 million of liabilities related to obligations under repurchase agreements within Other liabilities, and \$1.5 million of Non-controlling interest in equity of consolidated subsidiaries. \$75.6 million

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of securities held by Five Oaks and consolidated by XL are pledged as collateral under the repurchase agreements. The repurchase agreements do not provide the counterparties any recourse to assets of XL aside from its investment in Five Oaks. Amounts recorded within the Company's consolidated statement of income related to Five Oaks were immaterial during the three and six month periods ended June 30, 2012. In addition, the Company has purchased an equity interest in Oak Circle Capital Partners (Oak Circle), the investment management company that provides portfolio management and other administrative services to Five Oaks. XL's investment in Oak Circle has been accounted for using the equity method consistent with other investment manager affiliate positions held by the Company.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

The Company enters into derivative instruments for both risk management and investment purposes. The Company is exposed to potential loss from various market risks, and manages its market risks based on guidelines established by management and the Risk and Finance Committee of the Board of Directors of XL Group plc. The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value, with the changes in fair value of derivatives 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 that are designated as hedging instruments is described in Item 8, Note 2(h), Significant Accounting Policies Derivative Instruments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The following table summarizes information about the location and gross amounts of derivative fair values contained in the consolidated balance sheet at June 30, 2012 and December 31, 2011:

| | June 30, 2012 | | | | December 31, 2011 | | | |
|---|---|--|---|--|---|--|---|--|
| | Asset Derivative Notional Amount | Asset Derivative Fair Value (1) | Liability Derivative Notional Amount | Liability Derivative Fair Value (1) | Asset Derivative Notional Amount | Asset Derivative Fair Value (1) | Liability Derivative Notional Amount | Liability Derivative Fair Value (1) |
| <i>(U.S. dollars in thousands)</i> | | | | | | | | |
| Derivatives designed as hedging instruments: | | | | | | | | |
| Interest rate contracts (2) | \$ 156,254 | \$ 116,881 | \$ - | \$ - | \$ 156,271 | \$ 109,761 | \$ - | \$ - |
| Foreign exchange contracts | 1,932,505 | 57,315 | 724,842 | (5,883) | 2,033,428 | 25,387 | 457,892 | (4,518) |
| Total derivatives designed as hedging instruments | \$ 2,088,759 | \$ 174,196 | \$ 724,842 | \$ (5,883) | \$ 2,189,699 | \$ 135,148 | \$ 457,892 | \$ (4,518) |
| Derivatives not designed as hedging instruments: | | | | | | | | |
| <i>Investment Related Derivatives:</i> | | | | | | | | |
| Interest rate exposure | \$ 60,802 | \$ 2,229 | \$ 32,642 | \$ (163) | \$ 70,978 | \$ 1,946 | \$ 55,033 | \$ (43) |
| Foreign exchange exposure | 27,223 | 255 | 59,666 | (754) | 232,422 | 3,759 | 384,592 | (11,737) |
| Credit exposure | 91,250 | 1,624 | 374,013 | (15,015) | 172,500 | 5,271 | 449,513 | (13,986) |
| Financial market exposure | 43,578 | 718 | 15,476 | (597) | 23,874 | 615 | 14,321 | - |
| <i>Financial Operations Derivatives:</i> | | | | | | | | |
| <i>(3)</i> | | | | | | | | |
| Credit exposure (2) | - | - | 58,668 | (3,626) | - | - | 81,678 | (10,288) |
| <i>Other Non-Investment Derivatives:</i> | | | | | | | | |
| Guaranteed minimum income benefit contract | - | - | 70,352 | (21,404) | - | - | 78,777 | (22,490) |
| Modified coinsurance funds withheld contract | 73,929 | - | - | - | 77,200 | - | - | - |
| Total derivatives not designed as hedging instruments | \$ 296,782 | \$ 4,826 | \$ 610,817 | \$ (41,559) | \$ 576,974 | \$ 11,591 | \$ 1,063,914 | \$ (58,544) |

- (1) Derivative instruments in an asset or liability position are included within Other assets or Other liabilities, respectively, in the balance sheet on a net basis where the Company has both a legal right of offset and the intentions to settle the contracts on a net basis.
- (2) At June 30, 2012 and December 31, 2011, the Company held net cash collateral related to these derivative positions of \$124.7 million and \$77.1 million, respectively. The collateral balance is 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.

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(3) Financial operations derivatives represent interests in variable interest entities as described in Note 10, Variable Interest Entities.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(a) Derivative Instruments Designated as Fair Value Hedges

The Company designates certain of its derivative instruments as fair value hedges or cash flow hedges and formally and contemporaneously documents all relationships between the hedging instruments and hedged items and links the hedging derivative to specific assets and liabilities. The Company assesses the effectiveness of the hedge both at inception and on an on-going basis, and determines whether the hedge is highly effective in offsetting changes in fair value or cash flows of the linked hedged item.

At June 30, 2012 and 2011, a portion of the Company's liabilities are hedged against changes in the applicable designated benchmark interest rate. Interest rate swaps are also used to hedge the changes in fair value of certain fixed rate liabilities and fixed income securities due to changes in the designated benchmark interest rate. In addition, the Company utilizes foreign exchange contracts to hedge the fair value of certain fixed income securities as well as to hedge certain net investments in foreign operations.

The following table provides the total impact on earnings relating to derivative instruments formally designated as fair value hedges along with the impacts of the related hedged items for the three and six months ended June 30, 2012 and 2011:

| Derivatives Designated as Fair Value Hedges: Three Months Ended June 30, 2012 <i>(U.S. dollars in thousands)</i> | Hedged Items - Amount of Gain/(Loss) Recognized in Income Attributable to Risk | | | | Ineffective Portion of Hedging Relationship - Gain/(Loss) |
|--|---|------------------------|----------------------------------|-------------------|--|
| | Gain/(Loss) Recognized in Income on Derivative | Deposit Liabilities | Fixed Maturity Investments | | |
| Interest rate exposure | \$ 7,270 | | | | |
| Foreign exchange exposure | 7,297 | | | | |
| Total | \$ 14,567 | \$ (9,789) | \$ (6,972) | \$ (2,194) | |
| Three Months Ended June 30, 2011 <i>(U.S. dollars in thousands)</i> | | | | | |
| Interest rate exposure | \$ 5,726 | | | | |
| Foreign exchange exposure | (877) | | | | |
| Total | \$ 4,849 | \$ (6,672) | \$ 866 | \$ (957) | |
| Six Months Ended June 30, 2012 <i>(U.S. dollars in thousands)</i> | | | | | |
| Interest rate exposure | \$ 1,813 | | | | |
| Foreign exchange exposure | (7,803) | | | | |
| Total | \$ (5,990) | \$ (6,182) | \$ 7,539 | \$ (4,633) | |
| Six Months Ended June 30, 2011 <i>(U.S. dollars in thousands)</i> | | | | | |
| Interest rate exposure | \$ 4,852 | | | | |
| Foreign exchange exposure | (21,303) | | | | |

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| | | | | | | | | |
|-------|----|----------|----|---------|----|--------|----|-----|
| Total | \$ | (16,451) | \$ | (4,291) | \$ | 21,006 | \$ | 264 |
|-------|----|----------|----|---------|----|--------|----|-----|

The gains (losses) recorded on both the derivatives instruments and specific items designated as being hedged as part of the fair value hedging relationships outlined above are recorded through Net realized and unrealized gains (losses) on derivative instruments in the income statement along with any associated ineffectiveness in the relationships. In addition, the periodic coupon settlements relating to the interest rate swaps are recorded as adjustments to net investment income for the hedges of fixed maturity investments and as adjustments to interest expense for the hedges of deposit liabilities and notes payable and debt.

The periodic coupon settlements also resulted in decreases to Interest expense of \$2.5 million and \$4.9 million for the three and six months ended June 30, 2012, respectively, and decreases to Interest expense of \$2.6 million and \$5.1 million for the three and six months ended June 30, 2011, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

Settlement of Fair Value Hedges

During the year ended December 31, 2010, the Company settled the interest rate contracts designated as fair value hedges of certain of the Company's notes payable and debt and also settled three interest rate contracts designated as fair value hedges of certain of the Company's deposit liability contracts. The cumulative increase recorded to the carrying value of the hedged notes payable and debt of \$21.6 million, and the deposit liability contracts of \$149.5 million, representing the effective portion of the hedging relationship, is amortized through interest expense over the remaining terms of the debt and deposit liability contracts. A summary of the fair value hedges that were settled in 2010 and their results during the six months ended June 30, 2012 and 2011 is shown below:

| | Fair Value Hedges - Notes Payable and Debt June 30, | | Fair Value Hedges - Deposit Liabilities June 30, | |
|--|--|-----------|---|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Settlement of Fair Value Hedges - Summary <i>(U.S. dollars in thousands, except years)</i> | | | | |
| Cumulative reduction to interest expense | \$ 12,996 | \$ 7,432 | \$ 12,763 | \$ 5,646 |
| Remaining balance | \$ 8,628 | \$ 14,192 | \$ 136,722 | \$ 143,839 |
| Weighted average years remaining to maturity | 2.2 | 2.9 | 32.4 | 35.0 |

In July 2012, the Company settled two interest rate contracts designated as fair value hedges of certain of the Company's deposit liability contracts. At settlement, the cumulative increase recorded to the carrying value of the hedged deposit liability contracts was \$83.7 million. This amount will be amortized, through interest expense, over the remaining terms of the deposit liability contracts. The weighted average term remaining to maturity for these contracts was 16.1 years.

(b) Derivative Instruments Designated as Hedges of the Net Investment in a Foreign Operation

The Company utilizes foreign exchange contracts to hedge the fair value of certain net investments in foreign operations. During the six months ended June 30, 2012 and 2011, the Company entered into foreign exchange contracts that were formally designated as hedges of investments in foreign subsidiaries, the majority of which have functional currencies of either U.K. sterling or the Euro. There was no ineffectiveness in these transactions.

The following table provides the weighted average U.S. dollar equivalent of foreign denominated net assets that were hedged and the resultant gain (loss) that was recorded in the cumulative translation adjustment account within AOCI for the three and six months ended June 30, 2012 and 2011.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------------|------------------------------|--------------|
| | 2012 | 2011 | 2012 | 2011 |
| Derivative Instruments Designated as Hedges of the Net Investment in a Foreign Operation - Summary <i>(U.S. dollars in thousands)</i> | | | | |
| Weighted average of U.S. dollar equivalent of foreign denominated net assets | \$ 1,872,407 | \$ 1,656,083 | \$ 1,882,904 | \$ 1,542,979 |
| Derivative gains (losses) (1) | \$ 56,777 | \$ (27,797) | \$ 18,905 | \$ (69,206) |

(1) Derivative gains (losses) from derivative instruments designated as hedges of the net investment in a foreign operation are recorded in the cumulative translation adjustment account within AOCI for each period.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(c) Derivative Instruments Not Formally Designated As Hedging Instruments

The following table provides the total impact on earnings relating to derivative instruments not formally designated as hedging instruments under authoritative accounting guidance and from the ineffective portion of fair value hedges. The impacts are all recorded through Net realized and unrealized gains (losses) on derivatives in the income statement for the three and six months ended June 30, 2012 and 2011:

| Net Realized and Unrealized Gains (Losses) on Derivative Instruments | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-------------|------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| <i>(U.S. dollars in thousands)</i> | | | | |
| Investment Related Derivatives: | | | | |
| Interest rate exposure | \$ (83) | \$ (4,319) | \$ 617 | \$ (4,151) |
| Foreign exchange exposure | 683 | 11,014 | 329 | 17,451 |
| Credit exposure | 6,323 | (12,693) | 2,624 | (13,659) |
| Financial market exposure | (5,969) | (32) | (2,025) | 837 |
| Financial Operations Derivatives: | | | | |
| Credit exposure | - | 124 | 143 | 306 |
| Other Non-Investment Derivatives: | | | | |
| Contingent credit facility | - | (2,053) | - | (4,083) |
| Guaranteed minimum income benefit contract | (929) | (1,130) | 1,086 | 1,179 |
| Modified coinsurance funds withheld contract | (2,131) | (904) | (1,739) | (5,527) |
| Total derivatives not designated as hedging instruments | \$ (2,106) | \$ (9,993) | \$ 1,035 | \$ (7,647) |
| Amount of gain (loss) recognized in income from ineffective portion of fair value hedges | (2,194) | (957) | (4,633) | 264 |
| Net realized and unrealized gains (losses) on derivative instruments | \$ (4,300) | \$ (10,950) | \$ (3,598) | \$ (7,383) |

The Company's objectives in using these derivatives are explained below.

(d)(i) Investment Related Derivatives

The Company, either directly or through its investment managers, may use derivative instruments within its investment portfolio, including interest rate swaps, inflation swaps, credit derivatives (single name and index credit default swaps), options, forward contracts and financial futures (foreign exchange, bond and stock index futures), primarily as a means of economically hedging exposures to interest rate, credit spread, equity price changes and foreign currency risk or, in limited instances, for investment purposes. The Company is exposed to credit risk in the event of non-performance by the counterparties under any swap contracts, although the Company generally seeks to use credit support arrangements with counterparties to help manage this risk.

Investment Related Derivatives – Interest Rate Exposure

The Company utilizes risk management and overlay strategies that incorporate the use of derivative financial instruments, primarily to manage its fixed income portfolio duration and exposure to interest rate risks associated with primarily those assets and liabilities related to certain legacy other financial lines and structured indemnity transactions. The Company uses interest rate swaps to convert certain liabilities from a fixed rate to a variable rate of interest and may also use them to convert a variable rate of interest from one basis to another.

Investment Related Derivatives – Foreign Exchange Exposure

The Company has exposure to foreign currency exchange rate fluctuations through its operations and in its investment portfolio. The Company uses foreign exchange contracts to manage its exposure to the effects of fluctuating foreign currencies on the value of certain of its

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foreign currency fixed maturities primarily within its Life operations portfolio. These contracts are not designated as specific hedges for financial reporting purposes and, therefore, realized and unrealized gains and losses on these contracts are recorded in income in the period in which they occur. These contracts generally have maturities of twelve months or less.

In addition, certain of the Company's investment managers may, subject to investment guidelines, enter into forward contracts where potential gains may exist.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

Investment Related Derivatives - Credit Exposure

Credit derivatives may be purchased within the Company's investment portfolio in the form of single name and basket credit default swaps, which are used to mitigate credit exposure through a reduction in credit spread duration (i.e., macro credit strategies rather than single-name credit hedging) or exposure to selected issuers, including issuers that are not held in the underlying bond portfolio.

Investment Related Derivatives - Financial Market Exposure

Stock index futures may be purchased within the Company's investment portfolio in order to create synthetic equity exposure and to add value to the portfolio with overlay strategies where market inefficiencies are believed to exist. From time to time, the Company may enter into other financial market exposure derivative contracts on various indices including, but not limited to, inflation and commodity contracts.

(d)(ii) Financial Operations Derivatives - Credit Exposure

At June 30, 2012 and December 31, 2011, the Company held two credit derivative exposures that were written as part of the Company's previous financial lines business and are outside of the Company's investment portfolio: one provides credit protection on the senior tranches of a structured finance transaction; the other is a European project finance loan participation. An aggregate summary of these credit derivative exposures at June 30, 2012 and December 31, 2011 is as follows:

| Financial Operations Derivatives - Credit Exposure Summary: (U.S. dollars in thousands, except term to maturity) | June 30, 2012 | December 31, 2011 |
|--|--------------------------|----------------------------------|
| Principal outstanding | \$ 56,052 | \$ 78,425 |
| Interest outstanding | 2,616 | 3,253 |
| Aggregate outstanding exposure | \$ 58,668 | \$ 81,678 |
| Total liability recorded | \$ 3,626 | \$ 10,288 |
| Weighted average contractual term to maturity | 4.8 years | 5.0 years |
| Underlying obligations credit rating | BBB- | BB |

The credit protection related to the structured finance transaction is a credit default swap that was executed in 2000. The underlying collateral is predominantly securitized pools of leveraged loans and bonds. In the second quarter of 2012, the Company's exposure to this transaction was reduced by \$23.0 million mainly due to principal pay downs. Management continues to monitor the underlying performance. The European project finance loan participation benefits from an 80% deficiency guarantee from the German state and federal governments.

At June 30, 2012 and December 31, 2011, there were no reported events of default on these obligations. Credit derivatives are recorded at fair value based upon prices received from the investment bank counterparties and corroborated by using models developed by the Company. Although the Company does not have access to the specific unobservable inputs that may have been used in the value provided by the counterparties, it expects that the significant inputs considered would include changes in interest rates, future default rates, credit spreads, changes in credit quality, future expected recovery rates and other market factors. The change resulting from movements in credit and credit quality spreads is unrealized as the credit derivatives are not traded to realize this resultant value.

(d)(iii) Other Non-Investment Derivatives

The Company also has derivatives embedded in certain reinsurance contracts. For a particular life reinsurance contract, the Company pays the ceding company a fixed amount equal to the estimated present value of the excess of guaranteed benefit over the account balance upon the policyholder's election to take the income benefit. The fair value of this derivative is determined based on the present value of expected cash flows. In addition, the Company has modified coinsurance and funds withheld reinsurance agreements that provide for a return based on a portfolio of fixed income securities. As such, the agreements contain embedded derivatives. The embedded derivative is bifurcated from the funds withheld balance and recorded at fair value with changes in fair value recognized in earnings through Net realized and unrealized gains and losses on derivative instruments.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(e) Contingent Credit Features

Certain derivatives agreements entered into by the Company or its subsidiaries contain rating downgrade provisions that permit early termination of the agreement by the counterparty if collateral is not posted following failure to maintain certain credit ratings from one or more of the principal credit rating agencies. If the Company were required to early terminate such agreements due to a rating downgrade, it could potentially be in a net liability position at the time of settlement. The aggregate fair value of all derivatives agreements containing such rating downgrade provisions that were in a liability position and the collateral posted under any of these agreements as of June 30, 2012 and December 31, 2011 were as follows:

| Contingent Credit Features - Summary: (U.S. dollars in thousands) | June 30, 2012 | December 31, 2011 |
|---|--------------------------|----------------------------------|
| Aggregate fair value of derivative agreements with downgrade provisions in a net liability position | \$ 10,152 | \$ 15,763 |
| Collateral posted to counterparty | \$ - | \$ 809 |

7. Share Capital

(a) Authorized and Issued

Ordinary Share Buybacks

On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to \$750 million of its 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 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares under the new program for \$100.0 million and \$125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company's constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, \$525.0 million remained available for purchase under the new program.

(b) Stock Plans

The Company's performance incentive programs provide for grants of stock options, restricted stock, restricted stock units and performance units and stock appreciation rights. Share based compensation granted by the Company generally contains a vesting period of three or four years, and certain awards also contain performance conditions. The Company records compensation expense related to each award over its vesting period incorporating the best estimate of the expected outcome of performance conditions where applicable. Compensation expense is generally recorded on a straight line basis over the vesting period of an award. See Item 8, Note 18, Share Capital, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information on the Company's performance incentive programs and associated accounting.

During the six months ended June 30, 2012, the Company granted approximately 1.2 million stock options with a weighted-average grant date fair value of \$7.62 per option. The fair value of the options issued was estimated on the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions:

| | |
|-------------------------|-----------|
| Dividend yield | 1.90 % |
| Risk free interest rate | 1.16 % |
| Volatility | 46.0 % |
| Expected lives | 6.0 years |

During the six months ended June 30, 2012, the Company granted approximately 0.3 million restricted stock awards to certain employees and directors of the Company and its subsidiaries with an aggregate grant date fair value of approximately \$6.8 million. The award recipients generally have the rights and privileges of a shareholder as to the restricted stock, including the right to receive dividends and the right to vote

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such restricted stock. The recipients are not entitled to receive delivery of a stock certificate prior to vesting nor may any restricted stock be sold, transferred, pledged, or otherwise disposed of prior to the satisfaction of all vesting requirements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

7. Share Capital

During the six months ended June 30, 2012, the Company granted approximately 1.3 million restricted stock units to certain employees of the Company and its subsidiaries with an aggregate grant date fair value of approximately \$26.2 million. Each restricted stock unit represents the Company's obligation to deliver to the holder one ordinary share upon satisfaction of the three year vesting term. Restricted stock units are granted at the closing market price on the day of grant and entitle the holder to receive dividends declared and paid in the form of additional ordinary shares contingent upon vesting.

During the six months ended June 30, 2012, the Company granted approximately 1.5 million performance units (representing a potential maximum share payout of approximately 3.0 million ordinary shares) to certain employees with an aggregate grant date fair value of approximately \$29.2 million. The performance units vest after three years, subject to the achievement of stated performance metrics, and entitle the holder to ordinary shares of the Company. There are no dividend rights associated with the performance units. Each grant of performance units has a target number of shares, with final payouts ranging from 0% to 200% of the grant amount depending upon a combination of corporate and business segment performance along with each employee's continued service through the vest date. Performance targets are based on relative and absolute financial performance metrics.

8. Notes Payable and Debt and Financing Arrangements

(a) Notes Payable and Debt

All outstanding debt of the Company at June 30, 2012 and December 31, 2011 was issued by XLIT Ltd. (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 wholly-owned subsidiaries of XL Group plc. 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 Company's ability 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 the Company operates, including, among others, Bermuda, the United States, Ireland, Switzerland and the U.K. Aggregated required statutory capital and surplus for the principal operating subsidiaries of the Company was \$6.7 billion at December 31, 2011.

(b) Letter of Credit Facilities and Other Sources of Collateral

The Company has several letter of credit facilities provided on a syndicated and bilateral basis from commercial banks. These facilities are utilized primarily to support non-admitted insurance and reinsurance operations in the U.S. and capital requirements at Lloyd's. The Company's letter of credit facilities and revolving credit facilities at June 30, 2012 and December 31, 2011 were as follows:

| Letter of Credit Summary: <i>(U.S. dollars in thousands except percentages)</i> | June 30, 2012 (1) | December 31, 2011 (1) |
|---|------------------------------|--------------------------------------|
| Revolving credit facility (2) | \$ 1,000,000 | \$ 1,000,000 |
| Available letter of credit facilities - commitments (3) | \$ 4,000,000 | \$ 4,000,000 |
| Available letter of credit facilities - in use | \$ 1,728,948 | \$ 1,871,192 |
| Collateralized by certain assets of the Company's investment portfolio | 93.2% | 93.8% |

(1) At June 30, 2012 and December 31, 2011, there were five available letter of credit facilities.

(2) At June 30, 2012 and December 31, 2011, the revolving credit facility was unutilized.

(3) The Company has the option to increase the size of the March 2011 Credit Agreement by an additional \$500 million and the size of the facilities under the December 2011 Credit Agreements by an additional \$500 million across both such facilities..

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Related Party Transactions

At June 30, 2012, the Company owned minority stakes in four independent investment management companies (Investment Manager Affiliates) that are actively managing client capital and seeking growth opportunities. The Company seeks to develop relationships with specialty investment management organizations, generally acquiring an equity interest in the business. The Company also invests in certain of the funds and limited partnerships and other legal entities managed by these affiliates and through these funds and partnerships pays management and performance fees to the Company s Investment Manager Affiliates.

In the normal course of business, the Company enters into certain quota share reinsurance contracts with a subsidiary of one of its other strategic affiliates, ARX Holding Corporation. During the six months ended June 30, 2012 and 2011, these contracts resulted in reported net premiums written, net reported claims and reported acquisition costs as summarized below. Management believes that these transactions are conducted at market rates consistent with negotiated arms-length contracts.

| ARX Holding Corporation (U.S. dollars in thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Reported net premiums written | \$ 10,549 | \$ 8,713 | \$ 26,196 | \$ 22,772 |
| Net losses incurred | 7,862 | 5,570 | 15,823 | 13,261 |
| Reported acquisition costs | 6,136 | 5,218 | 12,613 | 11,067 |

10. Variable Interest Entities

At times, the Company has utilized variable interest entities (VIEs) both indirectly and directly in the ordinary course of the Company s business.

The Company invests in CDOs and other investment vehicles that are issued through VIEs as part of the Company s investment portfolio. The activities of these VIEs are generally limited to holding the underlying collateral used to service investments therein. The Company s involvement in these entities is passive in nature and we are not the arranger of these entities. In addition, the Company has not been involved in establishing these entities and is not the primary beneficiary of these VIEs as contemplated in current authoritative accounting guidance.

The Company has 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 VIEs. The Company is not the primary beneficiary of these VIEs as contemplated in current authoritative accounting guidance on the basis that management does not believe that the Company has the power to direct the activities, such as asset selection and collateral management, which most significantly impact each entity s economic performance. For further details on the nature of the obligations and the size of the Company s maximum exposure, see Note 6, Derivative Instruments, and Note 12 (a), Commitments and Contingencies Financial Guarantee Exposures.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 30, 2012 | June 30, 2011 | June 30, 2012 | June 30, 2011 |
| <i>(U.S. dollars in thousands, except per share amounts)</i> | | | | |
| Basic earnings per ordinary share & ordinary share equivalents outstanding: | | | | |
| Net income (loss) attributable to ordinary shareholders | \$ 221,156 | \$ 225,663 | \$ 397,784 | \$ (1,621) |
| Weighted average ordinary shares outstanding | 309,765 | 309,184 | 312,442 | 310,325 |
| Basic earnings per ordinary share & ordinary share equivalents outstanding | \$ 0.71 | \$ 0.73 | \$ 1.27 | \$ (0.01) |
| Diluted earnings per ordinary share & ordinary share equivalents outstanding: | | | | |
| Net income (loss) attributable to ordinary shareholders | \$ 221,156 | \$ 225,663 | \$ 397,784 | \$ (1,621) |
| Impact of assumed conversion of 10.75% Units | - | 11,977 | - | - |
| Net income (loss) attributable to ordinary shareholders including impact of assumed conversion of 10.75% Units | \$ 221,156 | \$ 237,640 | \$ 397,784 | \$ (1,621) |
| Weighted average ordinary shares outstanding - basic | 309,765 | 309,184 | 312,442 | 310,325 |
| Impact of share based compensation and certain conversion features | 2,670 | 32,805 | 2,568 | - |
| Weighted average ordinary shares outstanding - diluted | 312,435 | 341,989 | 315,010 | 310,325 |
| Diluted earnings per ordinary share & ordinary share equivalents outstanding | \$ 0.71 | \$ 0.69 | \$ 1.26 | \$ (0.01) |
| Dividends per ordinary share | \$ 0.11 | \$ 0.11 | \$ 0.22 | \$ 0.22 |

For the three and six months ended June 30, 2012 and 2011, ordinary shares available for issuance under share based compensation plans of 8.8 million and 9.0 million, and 9.7 million and 17.3 million, respectively, were not included in the calculation of diluted earnings per share because the assumed exercise or issuance of such shares would be anti-dilutive.

In addition, for the six months ended June 30, 2011, ordinary shares available for issuance under the purchase contracts associated with the 10.75% Units of 30.5 million were not included in the calculation of diluted earnings per share because the assumed issuance of such shares would be anti-dilutive. For further information on the 10.75% Units see Item 8, Note 15, Notes Payable and Debt Financing Arrangements, to the Consolidated Financial Statements in the Company's Annual Report on form 10-K for the year ended December 31, 2011.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

12. Commitments and Contingencies

(a) Financial Guarantee Exposures

| Financial Guarantee Exposure Summary <i>(U.S. dollars in thousands except number of contracts and term to maturity)</i> | June 30, 2012 | December 31, 2011 |
|---|--------------------------|----------------------------------|
| Opening number of financial guarantee contracts | 4 | 37 |
| Number of financial guarantee contracts matured, prepaid or commuted during the period | - | (33) |
| Closing number of financial guarantee contracts | 4 | 4 |
| Principal outstanding | \$ 115,464 | \$ 115,464 |
| Interest outstanding | \$ - | \$ - |
| Aggregate exposure outstanding | \$ 115,464 | \$ 115,464 |
| Total gross claim liability recorded | \$ 1,399 | \$ 1,399 |
| Total unearned premiums and fees recorded | \$ 352 | \$ 425 |
| Weighted average contractual term to maturity in years | 25.9 | 26.7 |

The Company's outstanding financial guarantee contracts at June 30, 2012 provide credit support for a variety of collateral types with the exposures comprised of (i) a \$108.3 million notional financial guarantee on three notes backed by zero coupon long dated bonds and bank perpetual securities, including some issued by European financials; and (ii) a \$7.2 million notional financial guarantee relating to future scheduled repayments on a government-subsidized housing project. At June 30, 2012, there were no reported events of default on these obligations.

Surveillance procedures to track and monitor credit deteriorations in the insured financial obligations are performed by the primary obligors for each transaction on the Company's behalf. Information regarding the performance status and updated exposure values is provided to the Company on a quarterly basis and evaluated by management in recording claims reserves.

(b) Claims and Other Litigation

The Company and its subsidiaries are subject to litigation and arbitration in the normal course of business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company's 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, the Company and its subsidiaries 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. This category of business litigation typically involves, among other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes 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, both individually and in the aggregate, will not result in losses having a material effect on the Company's financial position or liquidity at June 30, 2012.

If management believes that, based on available information, it is at least reasonably possible that a material loss (or additional material loss in excess of any accrual) will be incurred in connection with any legal actions or claims, the Company discloses an estimate of the possible loss or range of loss, either individually or in the aggregate, as appropriate, if such an estimate can be made, or discloses that an estimate cannot be made. Based on the Company's assessment at June 30, 2012, no such disclosures are considered necessary.

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

GENERAL

On July 1, 2010, XL Group plc, an Irish public limited company (XL-Ireland), and XL Group Ltd. (now known as XLIT Ltd.), a Cayman Islands exempted company (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. Prior to July 1, 2010, unless the context otherwise indicates, references in this Management's Discussion and Analysis of Financial Condition and Results of Operations to the Company are to XL-Cayman and its consolidated subsidiaries. On and subsequent to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to XL-Ireland and its consolidated subsidiaries.

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 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, as well as Item 1, Risk Factors, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

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 Annual Report on Form 10-K for the year ended December 31, 2011.

EXECUTIVE OVERVIEW

See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Executive Overview, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. That discussion is updated with the disclosures set forth below.

RESULTS OF OPERATIONS AND KEY FINANCIAL MEASURES

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 and six months ended June 30, 2012 and 2011:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------|------------------|------------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| <i>(U.S. dollars in thousands, except share and per share amounts)</i> | | | | |
| Net income (loss) attributable to ordinary shareholders | \$ 221,156 | \$ 225,663 | \$ 397,784 | \$ (1,621) |
| Earnings (loss) per ordinary share - basic | \$ 0.71 | \$ 0.73 | \$ 1.27 | \$ (0.01) |
| Earnings (loss) per ordinary share - diluted | \$ 0.71 | \$ 0.69 | \$ 1.26 | \$ (0.01) |
| Weighted average number of ordinary shares and ordinary share equivalents - basic | 309,765 | 309,184 | 312,442 | 310,325 |
| Weighted average number of ordinary shares and ordinary share equivalents - diluted | 312,435 | 341,989 | 315,010 | 310,325 |

Key Financial Measures

The following are some of the financial measures management considers important in evaluating the Company's operating performance in the Company's P&C operations:

| <i>(U.S. dollars in thousands, except ratios)</i> | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|--------------|
| | 2012 | 2011 | 2012 | 2011 |
| Underwriting profit (loss) - P&C operations | \$ 129,372 | \$ 67,049 | \$ 192,612 | \$ (261,015) |
| Combined ratio - P&C operations | 90.8% | 94.9% | 93.0% | 110.1% |
| Net investment income - P&C operations (1) | \$ 187,986 | \$ 214,448 | \$ 378,202 | \$ 417,735 |
| Annualized return on average ordinary shareholders' equity (2) | 9.0% | 9.6% | 8.3% | 0.0% |

| <i>(U.S. dollars)</i> | June 30, 2012 | December 31, 2011 |
|---|------------------|-------------------------|
| Book value per ordinary share (3) | \$ 32.27 | \$ 29.81 |
| Fully diluted book value per ordinary share (4) | \$ 31.96 | \$ 29.59 |

- (1) Net investment income relating to P&C operations includes the net investment income related to the net results from structured products.
- (2) Annualized return on average ordinary shareholders' equity (ROE) is a non-GAAP financial measure and is calculated by dividing the net income (loss) for the year by the average of the opening and closing ordinary shareholders' equity. See Annualized Return on Ordinary Shareholders' Equity Calculation herein for a reconciliation of ROE to average ordinary shareholders' equity.
- (3) 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 the Company's net income (loss), by any changes in the net unrealized gains and losses on its investment portfolio, by currency translation adjustments and also by the impact of any share buyback or issuance activity. Ordinary shareholders' equity was \$9.9 billion and \$9.4 billion and the number of ordinary shares outstanding was 305.7 million and 315.7 million at June 30, 2012 and December 31, 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.
- (4) Fully diluted book value per ordinary share, a non-GAAP financial measure, represents book value per ordinary share combined with the dilutive impact of potential future share issuances at period end. The Company believes that book value per share and fully diluted book value per ordinary share are financial measures important to investors and other interested parties. However, these measures may not be comparable to similarly titled measures used by companies either outside or inside of the insurance industry.

Underwriting profit - property and casualty (P&C) operations

One way that the Company evaluates the performance of its insurance and reinsurance operations is by 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 less net losses incurred and expenses related to underwriting activities. The Company's underwriting profit for the three and six months ended June 30, 2012 was consistent with the combined ratio discussed below.

Combined ratio - P&C operations

The combined ratio for P&C operations is used by the Company and many other 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 Company's insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss. The Company's combined ratio for the three and six months ended June 30, 2012 is lower than for the same periods in the previous year, as a result of a decrease in the loss and loss expense ratio partially offset by a marginal increase in the underwriting expense ratio. 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 overall lower levels of catastrophe losses and other large loss events for the three and six months ended June 30, 2012 as compared to the same periods of 2011. The increased underwriting expense ratio, which is the ratio of the sum of acquisition expenses and operating expenses to the net premiums earned, is reflective of the additional costs incurred from strategic initiatives and compensation costs.

Net investment income P&C operations

Net investment income related to P&C operations is an important measure that affects the Company's overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Company's 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.

Book value per ordinary share

Management also views the change in the Company's book value per ordinary share as an additional measure of the Company's performance. 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 the Company's net income (loss), by any changes in the net unrealized gains and losses on its investment portfolio, currency translation adjustments and also the impact of any share buyback or issuance activity. Ordinary shareholders' equity was \$9.9 billion and \$9.4 billion and the number of ordinary shares outstanding was 305.7 million and 315.6 million at June 30, 2012 and December 31, 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 \$1.13 in the three months ended June 30, 2012 and by \$2.46 in the six months ended June 30, 2012. These increases were due to the net income in both periods, an increase in net unrealized gains on investments and the benefit of share buyback activity. In the three months ended June 30, 2011 and the six months ended June 30, 2011, book value per share increased by \$1.59 and \$1.17, respectively, due to an increase in net unrealized gains on available for sale investments and the benefit of share buyback activity offset by catastrophe losses in the first quarter of 2011.

Fully diluted book value per ordinary share, a non-GAAP financial measure, represents book value per ordinary share combined with the dilutive impact of potential future share issuances at period end. In the three and six months ended June 30, 2012, fully diluted book value per ordinary share increased by \$1.08 and \$2.37, respectively, as a result of the factors contributing to the increase in book value per share noted above. In the three and six months ended June 30, 2011, fully diluted book value per share increased by \$1.84 and \$1.09, respectively, as a result of the factors contributing to the increase in book value per share noted above.

Annualized return on average ordinary shareholders' equity (ROE)

ROE is another non-GAAP financial measure that management considers important in evaluating the Company's operating performance. ROE is calculated by dividing the net income attributable to ordinary shareholders for any period by the average of the opening and closing ordinary shareholders' equity. The Company establishes minimum target ROEs for its total operations, segments and lines of business. If the Company's minimum ROE targets over the longer term are not met with respect to any line of business, the Company seeks to modify and/or exit this line. In addition, among other factors, the Company's compensation of its senior officers is dependent on the achievement of the Company's performance goals to enhance ordinary shareholder value as measured by ROE (adjusted for certain items considered to be non-operating in nature). For the six months ended June 30, 2012, annualized ROE was 8.3% and for the same period in the prior year it was negative due primarily to the net loss attributable to ordinary shareholders as a result of natural catastrophe losses in that period. See Annualized Return on Ordinary Shareholders' Equity Calculation herein for the calculation of annualized ROE to average ordinary shareholders' equity.

SIGNIFICANT ITEMS AFFECTING THE RESULTS OF OPERATIONS

The Company’s net income and other financial measures as shown above for the three and six months ended June 30, 2012 have been affected by, among other things, the following significant items:

- 1) the impact of significant large loss events;
- 2) market movement impacts on the Company’s investment portfolio; and
- 3) continuing competitive factors impacting the underwriting environment.

1) The impact of significant large loss events

The Company had a P&C underwriting profit of \$129.4 million and \$192.6 million for the three and six months ended June 30, 2012, respectively, compared to a P&C underwriting profit of \$67.0 and an underwriting loss of \$261.0 million for the same periods of 2011, respectively. The increase in underwriting profit in the three and six months ended June 30, 2012 was primarily due to lower levels of natural catastrophe losses and lower non-natural catastrophe large loss activity in energy, property and marine business units as explained further below.

Natural Catastrophe Losses

For the three months ended June 30, 2012, natural catastrophe losses net of reinsurance recoveries and including reinstatement premiums were \$60.6 million, compared to \$68.3 million in the same period of 2011.

For the six months ended June 30, 2012, natural catastrophe losses net of reinsurance recoveries and including reinstatement premiums were \$80.6 million, compared to \$455.7 million in the same period of 2011. Natural catastrophe losses in the first half of 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 and the severe weather occurrences, including tornado activity, in the United States over the periods April 22 - 28 and May 20 - 23, 2011.

Large Loss Events

The three and six months ended June 30, 2012 and 2011 were impacted by significant losses from large non-natural catastrophe loss events in both the Insurance and Reinsurance segments. In 2012, the impact was largely related to a single large marine loss during the first quarter. Management’s preliminary loss estimates for large marine loss activity in the six months ended June 30, 2012, net of reinsurance and reinstatement premiums, were \$46.6 million, of which \$24.3 million was attributable to the Insurance segment and \$22.3 million to the Reinsurance segment. In the three and six months ended June 30, 2011 the large loss activity relates to several losses in the International Property and Casualty (IPC) and North America Property and Casualty (NAPC) energy and property Insurance units and a large international marine loss.

See Income Statement Analysis, herein for further information regarding these large loss events within each of the Company’s operating segments.

2) Market movement impacts on the Company’s investment portfolio

During the three months ended June 30, 2012, interest rates decreased, partially offset by widening credit spreads. The net impact of the market conditions on the Company’s investment portfolio for the three months was favorable and resulted in an increase in the amount of \$141.4 million in net unrealized gains on available for sale investments as compared to March 31, 2012. This represents an approximately 0.3% appreciation in average assets for the three months ended June 30, 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:

| | |
|---|---|
| <p>Interest Rate Movement for the three months ended June 30, 2012 (1) (+ / - represents increases / decreases in interest rates)</p> | <p>Credit Spread Movement for the three months ended June 30, 2012 (2) (+ / - represents widening / tightening of credit spreads)</p> |
|---|---|

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| | | |
|----------------|------------------------------------|---|
| United States | -32 basis points (5 year Treasury) | +21 basis points (US Corporate A rated) +7 basis points (US Mortgage Master Index) +6 basis points (US CMBS, AAA rated) |
| United Kingdom | -47 basis points (10 year Gilt) | +14 basis points (UK Corporate, AA rated) |
| Euro-zone | -19 basis points (5 year Bund) | +19 basis points (Europe Corporate, A rated) |

(1) Source: Bloomberg Finance L.P.

(2) Source: Merrill Lynch Global Indices.

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Net realized losses on investments in the three months ended June 30, 2012 totaled \$12.4 million, including net realized losses of approximately \$28.2 million related to the impairment of certain of the Company's fixed income investments, where the Company determined that there was an other-than-temporary decline in the value of those investments related to credit. For further analysis of this, see Results of Operations below.

During the six months ended June 30, 2012, credit spreads tightened combined with decreasing interest rates. The net impact of the market conditions on the Company's investment portfolio for the six-month period was favorable and resulted in an increase in the amount of \$369.9 million in net unrealized gains on available for sale investments as compared to December 31, 2011. This represents an approximately 0.8% appreciation in average assets for the six months ended June 30, 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 six months ended June 30, 2012 (1) (+ / - represents increases / decreases in interest rates) | Credit Spread Movement for the six months ended June 30, 2012 (2) (+ / - represents widening / tightening of credit spreads) |
|----------------|---|---|
| United States | -11 basis points (5 year Treasury) | -52 basis points (US Corporate A rated) -7 basis points (US Mortgage Master Index) -58 basis points (US CMBS, AAA rated) |
| United Kingdom | -15 basis points (10 year Gilt) | -17 basis points (UK Corporate, AA rated) |
| Euro-zone | -24 basis points (5 year Bund) | -85 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 six months ended June 30, 2012 totaled \$8.4 million, including net realized losses of approximately \$49.2 million related to the impairment of certain of the Company's fixed income investments, where the Company determined that there was an other-than-temporary decline in the value of those investments related to credit. For further analysis of this, see Results of Operations below.

3) Continuing competitive factors impacting the underwriting environment

Insurance

The trading environment for the core lines of insurance business written by the Company remains competitive, although the gradual rate improvement which began in the second half of 2011 has been sustained through the first half of 2012. Gross premiums written in the Insurance segment increased in the three months ended June 30, 2012 as compared to the same period in 2011 by 1.6%. This premium increase was partly driven by improved pricing, further outlined below, and also from new business in NAPC property, construction and surplus lines, higher retention levels and new business in the U.S. D&O book, as well as growth in the new political risk and trade credit business.

Improved pricing contributed to the premium growth with an overall 4% rate improvement achieved for the segment during the second quarter of 2012. Rate improvement was experienced in all four business groups and nearly all of the segment's businesses. NAPC rates improved by 6% led by double digit increases in property and surplus lines businesses, a rate increase of 3% in IPC, a rate increase of 2% in Professional driven by U.S. D&O and an improvement in Specialty pricing of 5%, with the strongest movement in marine and offshore energy.

Reinsurance

The Reinsurance segment's gross premiums written decreased by 4.2% in the three months ended June 30, 2012 as compared to the same period in 2011. The premium decrease was predominantly from the North America, Latin America and International business groups, attributable to volume and share reductions, and selective cancelations, partially offset by premium growth from Bermuda.

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July 1 renewals saw pricing broadly in line with management's expectations. Both the primary and reinsurance markets remain highly competitive with substantial capacity available in both traditional and non-traditional forms. However, the Reinsurance segment will continue its disciplined underwriting and risk management strategies.

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. The Company continues its disciplined underwriting approach to grow on a very selective basis and exit lines where margins are unacceptable.

OTHER KEY FOCUSES OF MANAGEMENT

The Company remains focused on, among other things, managing its capital and enhancing its enterprise risk management capabilities. Details of these and other initiatives are outlined below.

Capital Management

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

Buybacks of Ordinary Shares

On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to \$750 million of its 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 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares, respectively, under the new program for \$100.0 million and \$125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company's constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, \$525.0 million remained available for purchase under the new 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 (XLCFE), was repaid at maturity. For further detail, see Item 1, Note 8, Notes Payable and Debt Financing Arrangements, to the Unaudited Consolidated Financial Statements included herein.

Risk Management

The Company's risk management and risk appetite framework is detailed in Item 1, Business - Enterprise Risk Management, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The table below shows the Company's 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. Finally, the probable maximum losses in the table below were derived by application of a vendor model that was released during the first quarter of 2011 and, accordingly, could be more unreliable than the model that was used historically.

| (U.S. dollars in millions) | Geographical Zone | Peril | Measurement Date of In-Force Exposures (1) | 1-in-100 Event | | 1-in-250 Event | |
|----------------------------|-------------------|---------------|--|---------------------------|---|---------------------------|---|
| | | | | Probable Maximum Loss (2) | Percentage of Tangible Shareholders Equity at June 30, 2012 | Probable Maximum Loss (2) | Percentage of Tangible Shareholders Equity at June 30, 2012 |
| North America | Earthquake | April 1, 2012 | \$ 877 | 8.1% | \$ 1,451 | 13.4% | |
| North Atlantic | Windstorm | April 1, 2012 | 1,303 | 12.1% | 1,724 | 16.0% | |
| U.S. | Windstorm | April 1, 2012 | 1,288 | 11.9% | 1,707 | 15.8% | |
| Europe | Windstorm | April 1, 2012 | 550 | 5.1% | 792 | 7.3% | |
| Japan | Earthquake | April 1, 2012 | 269 | 2.5% | 352 | 3.3% | |
| Japan | Windstorm | April 1, 2012 | 165 | 1.5% | 231 | 2.1% | |

(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)

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

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES

See the discussion of the Company's Critical Accounting Policies and Estimates in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

VARIABLE INTEREST ENTITIES AND OTHER OFF-BALANCE SHEET ARRANGEMENTS

For further information, see the discussion of the Company's variable interest entities and other off-balance sheet arrangements in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Variable Interest Entities (VIEs) and Other Off-Balance Sheet Arrangements, of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and Item 1, Note 10, Variable Interest Entities, to the Unaudited Consolidated Financial Statements included herein.

SEGMENTS

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 and the performance of the Life operations segment based on its contribution to net income. Other items of revenue and expenditure of the Company are not evaluated at the segment level for reporting purposes. In addition, the Company does not allocate investment assets by segment for its P&C operations. Investment assets related to the Company's 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 the applicable segment. See Item 1, Note 4, Segment Information, to the Unaudited Consolidated Financial Statements included herein for a reconciliation of segment data to the Company's Unaudited Consolidated Financial Statements.

INCOME STATEMENT ANALYSIS

Segment Results for the three months ended June 30, 2012 compared to the three months ended June 30, 2011

Insurance

The Company's Insurance segment provides 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, excess and surplus lines, political risk and trade credit, product recall, surety and other insurance coverages including those mentioned above, through the Company's program business. The Company focuses on those lines of business within its insurance operations that are believed to provide the best return on capital over time. These lines of business are divided into the following business groups: NAPC, IPC, Global Professional Lines (Professional) and Global Specialty (Specialty).

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

| (U.S. dollars in thousands) | Three Months Ended June 30, | | |
|---------------------------------|--------------------------------|--------------|----------|
| | 2012 | 2011 | % change |
| Gross premiums written | \$ 1,311,034 | \$ 1,290,030 | 1.6% |
| Net premiums written | 944,267 | 893,191 | 5.7% |
| Net premiums earned | 959,294 | 907,443 | 5.7% |
| Net losses and loss expenses | (635,284) | (608,182) | 4.5% |
| Acquisition costs | (123,284) | (113,883) | 8.3% |
| Operating expenses | (192,247) | (166,608) | 15.4% |
| Underwriting profit (loss) | \$ 8,479 | \$ 18,770 | (54.8)% |
| Net results structured products | 9,047 | 2,690 | 236.3% |
| Net fee income and other | (1,847) | (3,218) | (42.6)% |

Gross premiums written increased in the three months ended June 30, 2012 as compared to the same period of 2011 by 1.6% and, when evaluated in local currency, increased by 4.2%. All business groups with the exception of IPC experienced an increase in gross premiums written predominantly from new business, improved pricing and higher retention levels, partially offset by the unfavorable impact of foreign exchange rates and targeted non-renewals. For NAPC, the growth in premium was largely driven by new business growth and improved retention across most lines, and pricing mainly in property, partially offset by certain premium adjustments. In Professional, new business primarily in the U.S. professional business and improved pricing contributed to increased premiums but were partially offset by the non-renewal of under-priced business. In Specialty, there was premium growth from favorable amendments to prior year premium estimates, increased writings from the new business lines of political risk and product recall, and new business in marine cargo lines, partially offset by lower retention levels and adverse amendments to prior year premium estimates in aerospace. The decline in IPC was from lower retention and lower new business. The lower retention relates to the non-renewal of property accounts that did not meet the Company's pricing requirements.

Net premiums written increased by 5.7% in the three months ended June 30, 2012 as compared to the same period of 2011. The increase resulted from the gross written premium increases outlined above together with a decrease in ceded written premiums. The decrease in ceded premiums relates to decreased utilization of facultative reinsurance, primarily in IPC, following the cancellation of a large general property program, from lower cessions as a result of lower retention levels in IPC property and from reduced ceded reinstatement premiums related to marine losses partially offset by changes in the structure and cost of certain property reinsurance treaties.

Net premiums earned increased by 5.7% in the three months ended June 30, 2012 as compared to the same period of 2011. The increase primarily resulted from higher net written premiums earned in NAPC, Professional and Specialty partially offset by the decrease in IPC property premiums as outlined above.

The following table presents the ratios for the Insurance segment:

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| | Three Months Ended June 30, | |
|-----------------------------|--|-------------|
| | 2012 | 2011 |
| Loss and loss expense ratio | 66.2% | 67.0% |
| Acquisition expense ratio | 12.9% | 12.5% |
| Operating expense ratio | 20.0% | 18.4% |
| Underwriting expense ratio | 32.9% | 30.9% |
| Combined ratio | 99.1% | 97.9% |

The loss and loss expense ratio includes net losses incurred for both the current quarter 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 the net (favorable) adverse prior year development relating to the Insurance segment for the three months ended June 30, 2012 as compared to the same period of 2011:

| | Three Months Ended June 30, | |
|--|--|-------------|
| | 2012 | 2011 |
| <i>(U.S. dollars in millions, except ratios)</i> | | |
| Property | \$ 1.2 | \$ (16.7) |
| Casualty | (56.9) | 11.8 |
| Professional | (28.3) | (77.1) |
| Specialty and other | 41.1 | 18.3 |
| Total | \$ (42.9) | \$ (63.7) |
| Loss and loss expense ratio excluding prior year development | 70.7% | 74.0% |

Excluding prior year development, the loss ratio for the three months ended June 30, 2012 decreased by 3.3 loss percentage points as compared to the same period in 2011 despite higher levels of catastrophe losses occurring in the second quarter of 2012. Losses net of reinsurance recoveries and including reinstatement premiums recorded related to natural catastrophe events for the three months ended June 30, 2012 were \$ 49.3 million compared to \$13.1 million in the same period of 2011. Excluding favorable prior year development, net catastrophe losses and related reinstatement premiums in both quarters, the loss ratio for the three months ended June 30, 2012 compared to the same period of 2011 decreased by 6.8 points to 65.8%, mainly due to significant large loss activity in Specialty, specifically from marine and aerospace losses in the second quarter of 2011.

Net favorable prior year reserve development of \$42.9 million for the three months ended June 30, 2012 was mainly attributable to the following:

For property lines, net prior year development was \$1.2 million unfavorable.

For casualty lines, net prior year development was \$56.9 million favorable. This was driven by a release of \$34.6 million in primary casualty due to better than expected reported loss experience. The primary casualty releases related to the 2002 to 2007 accident years as well as the 2010 and 2011 accident years. There was also a release of \$30.0 million in the excess casualty lines due primarily to the favorable resolution of a mature claim. The releases in primary and excess casualty were partially offset by an increase of \$9.6 million in U.S. middle markets due to worse than expected reported loss experience.

For Professional, net prior year development was \$28.3 million favorable. This was driven by releases in reserves for clash losses (which cover a number of substantially similar claims against multiple policyholders) in the U.S. and Bermuda core professional businesses totaling \$50.4 million, comprised of a release of \$4.5 million for the 2006 and prior report years to reflect favorable reported loss experience across these years, and a release of \$45.9 million for report year 2010 to reflect the limited clash events in the U.S. and Bermuda core professional businesses for this year.

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In terms of non-clash losses in the professional lines, the International and Bermuda core professional businesses were strengthened by \$37.1 million and \$5.0 million, respectively, due to unfavorable reported loss development while \$24.5 million was released from the U.S. core professional business due to better than expected reported loss development. Finally, for the professional lines, the Design portfolio covering architects and engineers professional liability was strengthened by \$4.8 million driven by worse than expected reported loss experience in the Canadian book.

For specialty and other lines, net prior year development was \$41.1 million unfavorable. This was driven by adverse reported loss development for the non-catastrophe exposures in the excess and surplus lines, which led to a strengthening of \$30.0 million. For the same reason, marine was strengthened by \$12.6 million, run-off surety by \$12.5 million, programs by \$10.9 million and environmental by \$4.4 million. These increases were partially offset by a release of \$24.4 million in aerospace due to better than expected reported loss experience and a release of \$3.5 million for the catastrophe exposures in marine.

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The increase in the underwriting expense ratio for the three months ended June 30, 2012 as compared to the same period of 2011 was due to an increase in the operating expense ratio of 1.6 points combined with an increase in the acquisition expense ratio of 0.4 points. The increase in the operating expense ratio was due to higher compensation expenses due to different bonus accrual assumptions and severance costs in the three months ended June 30, 2012 as compared to the same period of 2011. The increase in the acquisition expense ratio was mainly from IPC due to higher premium taxes in the U.K. and Australia, and from Professional through changes in the mix of business.

Fee income and other improved in the three months ended June 30, 2012 as compared to the same period of 2011 as a result of expenses during the prior year in professional lines related to the cost of an endorsement facility with National Indemnity Company. For further information about this facility, see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Net results from structured insurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these contracts improved in the three months ended June 30, 2012 as compared to the same period of 2011 due to lower interest expense as a result of an accretion rate adjustment recorded in the three months ended June 30, 2012 based on changes in expected cash flows and payout patterns on certain structured indemnity contracts.

Reinsurance

The Company's 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. The reinsurance operations are structured into geographical business groups: North America, Bermuda, International (Europe and Asia Pacific) and Latin America.

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

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, | | |
|------------------------------------|--|------------------|-----------------|
| | 2012 | 2011 | % change |
| Gross premiums written | \$ 452,417 | \$ 472,413 | (4.2)% |
| Net premiums written | 403,011 | 412,868 | (2.4)% |
| Net premiums earned | 441,678 | 398,682 | 10.8% |
| Net losses and loss expenses | (191,071) | (215,402) | (11.3)% |
| Acquisition costs | (87,723) | (91,448) | (4.1)% |
| Operating expenses | (41,991) | (43,553) | (3.6)% |
| Underwriting profit (loss) | \$ 120,893 | \$ 48,279 | 150.4% |
| Net results - structured products | (22,913) | 2,226 | *NM |
| Fee income and other | 990 | (9) | *NM |

* NM - Not Meaningful

Gross premiums written decreased in the three months ended June 30, 2012 as compared to the same period of 2011 by 4.2% and, when evaluated in local currency, decreased by 3.4%. The premium decrease was predominantly from the International and North America business groups. The gross premiums written decline from the International business group was mainly as a result of changes in the renewal timing of certain casualty quota share contracts and the absence of positive premium adjustments in the three months ended June 30, 2012 when compared to the same period of 2011. The North America business group experienced a decrease in gross premiums written, driven by a reduction in volume, shares and price for certain renewed property quota share and property excess of loss contracts, as well as changes in the structure of a U.S. agricultural program. Premiums from the Latin America business group declined compared to the prior year quarter due to the timing of certain property renewals. Offsetting these declines was premium growth for the Bermuda business group through both the timing of, and increased shares from property catastrophe renewals. In 2011, the renewal dates for certain policies normally bound in the second quarter were pushed back into the third quarter as a result of the Japan earthquake and tsunami.

Net premiums written decreased by 2.4% in the three months ended June 30, 2012 as compared to the same period of 2011. The decrease resulted from the gross written premium decreases outlined above offset by a reduction in ceded written premiums. The decrease in ceded written premiums was mainly from the North America business group reflecting the change in structure of the U.S. agricultural program,

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partially offset by increased ceded premiums in the Bermuda business group.

Net premiums earned increased by 10.8% in the three months ended June 30, 2012 as compared to the same period of 2011. The increase is a reflection of the overall growth in net premiums written in recent quarters particularly from the Bermuda and International business groups.

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The following table presents the ratios for the Reinsurance segment:

| | Three Months Ended June 30, | |
|-----------------------------|--|-------------|
| | 2012 | 2011 |
| Loss and loss expense ratio | 43.3% | 54.0% |
| Acquisition expense ratio | 19.9% | 22.9% |
| Operating expense ratio | 9.4% | 11.0% |
| Underwriting expense ratio | 29.3% | 33.9% |
| Combined ratio | 72.6% | 87.9% |

The loss and loss expense ratio includes net losses incurred for both the current 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 the net (favorable) adverse prior year development relating to the Reinsurance segment for the three months ended June 30, 2012 and 2011:

| | Three Months Ended June 30, | |
|--|--|------------------|
| | 2012 | 2011 |
| <i>(U.S. dollars in millions, except ratios)</i> | | |
| Property and other short-tail lines | \$ (11.5) | \$ (24.8) |
| Casualty and other | (46.9) | (39.1) |
| Total | \$ (58.4) | \$ (63.9) |
| Loss and loss expense ratio excluding prior year development | 56.5% | 70.1% |

Excluding prior year development, the loss ratio for the three months ended June 30, 2012 decreased by 13.6 loss percentage points as compared to the same period of 2011. Losses net of reinsurance recoveries and including reinstatement premiums recorded related to natural catastrophe events for the three months ended June 30, 2012 were \$11.2 million compared to \$55.2 million in the same period of 2011. For further details on catastrophe losses in 2011, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Significant Items Affecting the Results of Operations 1) The impact of significant large natural catastrophe activity, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Excluding favorable prior year development, net catastrophe losses and related reinstatement premiums in both quarters, the loss ratio for the three months ended June 30, 2012 compared to the same period of 2011 decreased by 2.3 points to 53.7% mainly due to higher levels of losses from the property other lines in Latin America incurred in 2011.

Net favorable prior year reserve development of \$58.4 million for the three months ended June 30, 2012 was mainly attributable to the following:

Net favorable prior year development of \$11.5 million for the short-tailed lines and details of these by specific lines are as follows:

For property catastrophe lines, net prior year development was \$0.1 million favorable.

For property other lines, net prior year development was \$6.5 million favorable mainly due to favorable attritional claim development on the North America and Bermuda business groups offset by some unfavorable attritional claim development on the Latin America business group.

For marine and aviation lines, net prior year development was \$4.9 million favorable due mainly to favorable attritional claim development together with releases on one old aviation loss.

Net favorable prior year development of \$46.9 million for the long-tailed lines and details of these by specific lines are as follows.

For casualty lines, net prior year development was \$39.3 million favorable arising mainly out of the North America business group due to better than expected development on the 2003 and 2004 underwriting years.

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For other lines, net prior year development was \$7.6 million favorable driven by a release on the structured indemnity book.

The decrease in the underwriting expense ratio for the three months ended June 30, 2012 as compared to the same period of 2011 was due to a reduction in the operating expense ratio of 1.6 points and a reduction in the acquisition expense ratio of 3 points. The decrease in the operating expense ratio was due to lower compensation expenses, as a result of severance costs in 2011 and reduced professional fees as compared to the same period of 2011. The decrease in the acquisition expense ratio was largely from decreased profit commissions paid.

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Net results from structured reinsurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these contracts have decreased in the three months ended June 30, 2012 as compared to the same period of 2011 due to higher interest expense. The higher interest expense was due to an accretion rate adjustment recorded in the three months ended June 30, 2012 based on changes in expected cash flows and payout patterns on one of the larger structured indemnity contracts and from lower net investment income in the period reflecting lower investment yields and the run-off nature of this line of business.

Life Operations

The following table summarizes the contribution from the Life operations segment, which has been in run-off since 2009. Prior to the decision to run-off the business, products offered included a broad range of underlying lines of life reinsurance business, including term assurances, group life, critical illness cover, immediate annuities and disability income. In addition, prior to selling the renewal rights to the Continental European Business, the products offered included short-term life, accident and health business. The segment also covers a range of geographic markets, with an emphasis on the U.K., United States, Ireland and Continental Europe:

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, | | | % change |
|--|--|------------------|--|-----------------|
| | 2012 | 2011 | | |
| Gross premiums written | \$ 92,904 | \$ 100,281 | | (7.4)% |
| Net premiums written | 85,623 | 92,194 | | (7.1)% |
| Net premiums earned | 85,623 | 92,214 | | (7.1)% |
| Net losses and loss expenses | (131,150) | (137,416) | | (4.6)% |
| Acquisition costs | (7,930) | (9,768) | | (18.8)% |
| Operating expenses | (2,829) | (2,723) | | 3.9% |
| Net investment income | 74,645 | 82,057 | | (9.0)% |
| Net fee income and other | 42 | 96 | | (56.3)% |
| Realized gains (losses) on investments | (10,239) | 704 | | *NM |
| Contribution from Life operations | \$ 8,162 | \$ 25,164 | | (67.6)% |

* NM - Not Meaningful

The following table is an analysis of the Life operations gross premiums written, net premiums written and net premiums earned for the three months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, 2012 | | | Three Months Ended June 30, 2011 | | |
|------------------------------------|---|-------------------------------------|------------------------------------|---|-------------------------------------|------------------------------------|
| | Gross Premiums Written | Net Premiums Written | Net Premiums Earned | Gross Premiums Written | Net Premiums Written | Net Premiums Earned |
| Other Life | \$ 54,713 | \$ 54,380 | \$ 54,380 | \$ 58,751 | \$ 58,226 | \$ 58,246 |
| Annuity | 38,191 | 31,243 | 31,243 | 41,530 | 33,968 | 33,968 |
| Total | \$ 92,904 | \$ 85,623 | \$ 85,623 | \$ 100,281 | \$ 92,194 | \$ 92,214 |

Gross premiums written decreased by 7.4% in the three months ended June 30, 2012 as compared to the same period of 2011, across the lines of business. The decrease was in line with the run-off expectations combined with unfavorable foreign exchange movements. Ceded premiums written marginally decreased largely due to timing differences.

Net premiums earned decreased by 7.1% in the three months ended June 30, 2012 as compared to the same period of 2011. This decrease was consistent with the decrease in gross and net premiums written as described above.

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Claims and policy benefit reserves decreased by 4.6% in the three months ended June 30, 2012 as compared to the same period of 2011, as a result of the factors noted above affecting gross and net premiums written, the impact of foreign exchange movements and claims volatility.

Acquisition costs decreased by 18.8% in the three months ended June 30, 2012 as compared to the same period of 2011, mainly due to the impact of accrual adjustments in the prior year that were one-off in nature.

Operating expenses increased by 3.9% in the three months ended June 30, 2012 or \$0.1 million, as compared to the same period in the prior year.

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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. Net investment income decreased by 9.0% in the three months ended June 30, 2012 as compared to the same period of 2011 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.

Investment Activities

The following table illustrates the change in 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 derivative instruments for the three months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, | | |
|---|--|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net investment income - P&C operations (1) | \$ 187,986 | \$ 214,448 | (12.3)% |
| Net income (loss) from investment fund affiliates (2) | 3,097 | 10,250 | (69.8)% |
| Net realized gains (losses) on investments | (12,393) | (9,544) | 29.9% |
| Net realized and unrealized gains (losses) on investment and other derivative instruments (3) | (4,300) | (10,950) | (60.7)% |

- (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 in order for the Company to meet the filing deadlines for its periodic reports.
- (3) For a summary of realized and unrealized gains and losses on all derivative instruments, see Item 1, Note 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

Net investment income related to P&C business decreased in the three months ended June 30, 2012 as compared to the same period of 2011 due primarily to a reduction in investment yields and cash outflows from the investment portfolio.

Net income from investment fund affiliates decreased in the three months ended June 30, 2012 as compared to the same period of 2011. This was driven by moderately negative results from alternative fund affiliates as compared to positive results in the three months ended June 30, 2011, partially offset by an improvement in the returns from private funds.

The Company manages its fixed income portfolio in accordance with investment authorities approved by the Risk and Finance Committee of the Board of Directors of XL-Ireland. The following is a summary of the investment portfolio returns for the three months ended June 30, 2012 and 2011 of the fixed income and non-fixed income portfolios:

| | Three Months Ended June 30, | |
|------------------------------------|--|-----------------|
| | 2012 (1) | 2011 (1) |
| Total Return on Investments | 1.4% | 1.7% |
| P&C fixed income portfolio | 1.0% | 1.6% |
| Life fixed income portfolio | 2.7% | 2.0% |
| Other Portfolios | | |
| Alternative portfolio (2) | (0.3)% | 1.1% |
| Equity portfolio | (6.9)% | 1.3% |
| High-Yield fixed income portfolio | 1.2% | 0.2% |

(1)

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Portfolio returns 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. The performance of investment portfolios are measured on a local currency basis. 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 the alternative portfolio reflects the three months ended May 31, 2012 and 2011, respectively.

Net Realized Gains and Losses on Investments and Other-than-Temporary Declines in the Value of Investments

Net realized losses on investments of \$12.4 million in the three months ended June 30, 2012 included net realized losses of approximately \$28.2 million related to the write-down of certain of the Company's AFS investments as well as losses arising on targeted sales of European financial exposures, partially offset by net realized gains of \$24.0 million on sales of equity securities.

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The significant components of the net impairment charges of \$28.2 million for the three months ended June 30, 2012 were:

\$14.3 million for structured securities where the Company 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.

\$10.2 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. The Company also adjusted the estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.

\$2.2 million related to currency losses primarily arising on U.K. sterling denominated securities held in U.S. dollar portfolios.

\$1.5 million related to equities as the holding was more than 50% impaired.

Net realized losses on investments during the three months ended June 30, 2011 included net realized losses of \$27.2 million related to the write-down of certain of the Company's fixed income, equity and other investments with respect to which the Company determined that there was an other-than-temporary decline in the value of those investments as well as net realized gains of \$17.7 million from sales of investments.

Net Realized and Unrealized Gains and Losses on Derivatives

Net realized and unrealized losses on derivatives of \$4.3 million in the three months ended June 30, 2012 resulted from the Company's 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 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

Other Revenues and Expenses

The following table sets forth other revenues and expenses of the Company for the three months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, | | |
|---|--|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net income (loss) from operating affiliates (1) | \$ 22,561 | \$ 46,251 | (51.2)% |
| Exchange gains (losses) | 17,976 | 8,498 | 111.5% |
| Corporate operating expenses | (50,061) | (39,566) | 26.5% |
| Interest expense (2) | (26,089) | (41,599) | (37.3)% |
| Income tax (benefit) expense | 29,812 | 24,826 | 20.1% |

(1) The Company generally records 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 structured products recorded in the Insurance and Reinsurance segments.

The following table sets forth the net income (loss) from operating affiliates for the three months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Three Months Ended June 30, | | |
|---|--|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net income (loss) from financial operating affiliates | \$ - | \$ (1,018) | (100.0)% |
| Net income (loss) from investment manager affiliates | 14,052 | 41,345 | (66.0)% |
| Net income (loss) from strategic operating affiliates | 8,509 | 5,924 | 43.6% |

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| | | | | | |
|-------|----|--------|----|--------|---------|
| Total | \$ | 22,561 | \$ | 46,251 | (51.2)% |
|-------|----|--------|----|--------|---------|

The financial operating affiliate loss in the three months ended June 30, 2011 is wholly attributable to a write down in value of one investment following a restructuring.

Investment manager affiliate income decreased in the three months ended June 30, 2012 as compared to the same period in the prior year due to an especially strong quarter for certain investment manager affiliates in the second quarter of 2011 as a result of

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both strong performance by the investment manager affiliates and the achievement of results that surpassed certain fee hurdles by various funds under management, as compared to solid results for the investment manager affiliates in the second quarter of this year.

Strategic operating affiliate income increased in the three months ended June 30, 2012 as compared to the three months of 2011 due to a loss on one of the strategic operating affiliates in the three months ended June 30 2011.

Foreign exchange gains in the three months ended June 30, 2012 were a result of an overall strengthening of the value of the U.S. dollar against the Company's major currency exposures, which include the Euro, U.K. sterling and the Swiss franc.

Corporate operating expenses increased in the three months ended June 30, 2012 as compared to the same period in the prior year primarily as a result of certain strategic corporate initiatives taking place in 2012.

Interest expense decreased in the three months ended June 30, 2012 as compared to the same period in the prior year as a result of the overall reduction in the Company's debt following the repayment at maturity on January 15, 2012 of \$600 million principal amount outstanding 6.5% XLCFE Notes, the purchase and retirement of the \$575 million principal amount outstanding 8.25% Senior Notes in August 2011, offset by the issuance of \$400 million principal amount outstanding 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, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

A tax charge of \$29.8 million was incurred in the three months ended June 30, 2012. The Company recognized a tax charge of \$24.8 million in the three months ended June 30, 2011, which included a benefit of \$11.9 million arising as a result of a change in an overseas tax rule adopted in the three months ended June 30, 2011. Excluding this benefit, the decrease in the Company's income tax expense in the three months ended June 30, 2012 compared to the same quarter in 2011 reflects the Company's expected full year effective tax rate applicable in each of the years.

Segment Results for the six months ended June 30, 2012 compared to the six months ended June 30, 2011

Insurance

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

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|------------------------------------|--------------------------------------|--------------|-----------------|
| | 2012 | 2011 | % change |
| Gross premiums written | \$ 2,647,668 | \$ 2,512,379 | 5.4% |
| Net premiums written | 1,980,793 | 1,812,181 | 9.3% |
| Net premiums earned | 1,893,350 | 1,783,363 | 6.2% |
| Net losses and loss expenses | (1,266,969) | (1,396,695) | (9.3)% |
| Acquisition costs | (251,540) | (221,527) | 13.5% |
| Operating expenses | (377,593) | (330,703) | 14.2% |
| Underwriting profit (loss) | \$ (2,752) | \$ (165,562) | (98.3)% |
| Net results - structured products | 11,866 | 5,950 | 99.4% |
| Net fee income and other | (3,867) | (9,130) | (57.6)% |

Gross premiums written increased in the six months ended June 30, 2012 as compared to the same period of 2011 by 5.4% and, when evaluated in local currency, increased by 7.4%. This increase was experienced across the business groups predominantly from new business, improved pricing and higher retention levels, partially offset by the unfavorable impact of foreign exchange rates. For NAPC, the growth in premium was largely driven by new business growth across most lines, improved retention for construction, property and primary casualty, and improved pricing mainly in property over the prior year, partially offset by certain premium adjustments in environmental and excess casualty. In Professional, improved pricing and new business primarily in the U.S. professional business and favorable amendments to prior year premium estimates and retention levels contributed to increased premiums but were partially offset by the non-renewal of certain under-priced business. In Specialty, there was premium growth from favorable amendments to prior year premium estimates, increased writings from the new business lines of political risk and product recall, new business in marine cargo lines, partially offset by lower retention levels and adverse amendments to prior year premium estimates in aerospace. Finally, there was a decline in gross premiums written in IPC from lower retention and reduced new business in property and primary casualty. The lower retention relates to the non-renewal of property accounts that did not meet the Company's pricing requirements. Partially offsetting these declines was improved retention levels and growth over the prior year in middle market lines.

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Net premiums written increased by 9.3% in the six months ended June 30, 2012 as compared to the same period of 2011. The increase resulted from the gross written premium increases outlined above together with a decrease in ceded written premiums. The decrease in ceded premiums relates to decreased utilization of facultative reinsurance, primarily in IPC, following the cancelation of a

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large general property program, from lower cessions as a result of lower retention levels in IPC property, as outlined above, and from reduced ceded reinstatement premiums related to marine losses, partially offset by changes in the structure and costs of certain property reinsurance treaties.

Net premiums earned increased by 6.2% in the six months ended June 30, 2012 as compared to the same period of 2011. The increase primarily resulted from higher net written premiums earned in NAPC, Professional and Specialty, and the favorable amendments to certain prior year premium estimates partially offset by marine reinstatement premiums.

The following table presents the ratios for the Insurance segment:

| | Six Months Ended June 30, | |
|-----------------------------|------------------------------|--------|
| | 2012 | 2011 |
| Loss and loss expense ratio | 66.9% | 78.3% |
| Acquisition expense ratio | 13.3% | 12.4% |
| Operating expense ratio | 19.9% | 18.6% |
| Underwriting expense ratio | 33.2% | 31.0% |
| Combined ratio | 100.1% | 109.3% |

The loss and loss expense ratio includes net losses incurred for both the current quarter 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 the net (favorable) adverse prior year development relating to the Insurance segment for the six months ended June 30, 2012 as compared to the same period of 2011:

| | Six Months Ended June 30, | |
|--|------------------------------|-----------|
| | 2012 | 2011 |
| <i>(U.S. dollars in millions, except ratios)</i> | | |
| Property | \$ (17.0) | \$ (23.7) |
| Casualty | (61.9) | 12.0 |
| Professional | (52.6) | (75.3) |
| Specialty and other | 34.7 | 16.7 |
| Total | \$ (96.8) | \$ (70.3) |
| Loss and loss expense ratio excluding prior year development | 72.0% | 82.3% |

Excluding prior year development, the loss ratio for the six months ended June 30, 2012 decreased by 10.3 loss percentage points as compared to the same period in 2011 due to lower levels of catastrophe losses occurring in 2012. Catastrophe and large loss activity net of reinsurance recoveries and including reinstatement premiums was \$76.4 million lower for the first six months of 2012 as compared to the same period of 2011. For further details on catastrophe losses in 2011 see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Significant Items Affecting the Results of Operations 1) The impact of significant large natural catastrophe activity, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Excluding favorable prior year development, net catastrophe losses and related reinstatement premiums in both periods, the loss ratio for the six months ended June 30, 2012 compared to the same period of 2011 decreased by 5.6 points to 68.5%, due to significant large loss activity in the IPC and NAPC energy and property units in the first quarter of 2011 partially offset by a large marine loss in the first quarter of 2012.

Net favorable prior year reserve development of \$96.8 million for the six months ended June 30, 2012 was mainly attributable to the following:

For property lines, net prior year development was \$17.0 million favorable. This was driven by releases of \$17.3 million and \$3.2 million for the non-catastrophe exposures in the property and energy books, respectively, due to better than expected reported loss experience mainly in the 2011 accident year. This favorable experience was partially offset by adverse development of \$7.3 million in the construction

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book also primarily attributable to the 2011 accident year and again for the non-catastrophe exposures. The catastrophe exposures saw releases totaling \$2.8 million overall with \$6.6 million arising from the 2010 accident year offset by a strengthening of \$3.3 million in the 2011 accident year.

For casualty lines, net prior year development was \$61.9 million favorable. This was driven by a release of \$34.8 million in the primary casualty business due to better than expected reported loss experience. The primary casualty releases related to the 2002 to 2007 accident years as well as the 2010 and 2011 accident years. There was also a release of \$37.5 million in the excess casualty lines due primarily to the favorable resolution of a mature claim. The releases in primary and excess casualty were partially offset by strengthening of \$9.6 million in U.S. middle markets due to worse than expected loss experience.

For Professional, net prior year development was \$52.6 million favorable. This was driven by releases in reserves for clash losses (which cover a number of substantially similar claims against multiple policyholders) in the U.S. and Bermuda core professional

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businesses totaling \$50.4 million. This was comprised of a release of \$4.5 million for the 2006 and prior report years to reflect favorable reported loss experience across these years, and a release of \$45.9 million for report year 2010 to reflect the limited clash events in the U.S. and Bermuda core professional businesses for this year.

In terms of non-clash losses in the professional lines, \$24.5 million and \$18.1 million was released from the U.S. and Bermuda core professional businesses, respectively, due to better than expected reported loss development while the International core professional business was strengthened by \$37.1 million due to unfavorable reported loss development. Finally for the professional lines, the Design portfolio covering architects and engineers professional liability was strengthened by \$4.8 million driven by worse than expected reported loss experience in the Canadian book.

For specialty and other lines, net prior year development was \$34.7 million unfavorable. This was driven by adverse reported loss development for the non-catastrophe exposures in the excess and surplus lines, which led to a strengthening of \$30.0 million. For the same reason, marine was strengthened by \$13.3 million, run-off surety by \$12.5 million, programs by \$10.9 million and environmental by \$4.4 million. These increases were partially offset by releases of \$25.0 million in aerospace and \$3.2 million in discontinued lines due to better than expected reported loss experience, and a release of \$8.9 million for the catastrophe exposures in marine.

The increase in the underwriting expense ratio for the six months ended June 30, 2012 as compared to the same period of 2011 was due to an increase in the operating expense ratio of 1.3 points combined with an increase in the acquisition expense ratio of 0.9 points. The increase in the operating expense ratio was due to higher compensation expenses due to different bonus accrual assumptions and severance costs in the six months ended June 30, 2012 as compared to the same period of 2011. The increase in the acquisition expense ratio was largely from the impact of marine reinstatement premiums and other earned premium adjustments on the ratio, and a change in the mix of business in Professional.

Fee income and other improved in the six months ended June 30, 2012 as compared to the same period of 2011 mainly as a result of expenses during the prior year in professional lines related to the cost of an endorsement facility with National Indemnity Company. For further information about this facility, see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Net results from structured insurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these contracts have improved in the six months ended June 30, 2012 as compared to the same period of 2011 due to a lower interest expense as a result of an accretion rate adjustment recorded in the current quarter based on changes in expected cash flows and payout patterns on certain structured indemnity contracts.

Reinsurance

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

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|------------------------------------|--------------------------------------|--------------|-----------------|
| | 2012 | 2011 | % change |
| Gross premiums written | \$ 1,432,767 | \$ 1,349,184 | 6.2% |
| Net premiums written | 1,329,713 | 1,208,160 | 10.1% |
| Net premiums earned | 865,520 | 794,458 | 8.9% |
| Net losses and loss expenses | (413,451) | (635,754) | (35.0)% |
| Acquisition costs | (175,967) | (164,974) | 6.7% |
| Operating expenses | (80,738) | (89,183) | (9.5)% |
| Underwriting profit (loss) | \$ 195,364 | \$ (95,453) | *NM |
| Net results structured products | (20,415) | 6,440 | *NM |
| Fee income and other | 1,323 | 1,385 | (4.5)% |

* NM - Not Meaningful

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Gross premiums written increased in the six months ended June 30, 2012 as compared to the same period of 2011 by 6.2% and, when evaluated in local currency, increased by 7.7%. The premium growth was predominantly from the International business group, attributable to casualty lines through new writings and higher renewals; increased property catastrophe shares and rates in Continental Europe; and new business and increased shares in Asia Pacific property proportional lines of business. For the Bermuda business group, there was premium growth from renewals both through price and capacity increases and from the timing of certain Japanese treaties, since in 2011, the renewal dates and periods of cover were affected by the Japan earthquake and tsunami. These were partially offset by the absence of property catastrophe reinstatement premiums in the Bermuda and International business units, which were written and earned in the same period of 2011 in connection with natural catastrophe losses from the Japan earthquake and

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tsunami. The North America business group experienced a decrease in gross premiums written, driven by a reduction in volume, shares and price for certain renewed property quota share and property excess of loss contracts, as well as from changes in the structure of a U.S. agricultural program partially offset by new business. Premiums from the Latin America business group declined compared to the same period of the prior year mainly due to the timing of certain property renewals.

Net premiums written increased by 10.1% in the six months ended June 30, 2012 as compared to the same period of 2011. The increase resulted from the gross written premium increases outlined above coupled with a reduction in ceded written premiums. The decrease in ceded written premiums was mainly from the North America business group reflecting the change in structure of a U.S. agricultural program, partially offset by increased ceded reinstatement premiums in the International business group related to the 2011 Thailand flood loss.

Net premiums earned increased by 8.9% in the six months ended June 30, 2012 as compared to the same period of 2011. The increase is a reflection of the overall growth in net premiums written in recent quarters partially offset by the increase, in 2011, of reinstatement premiums on catastrophe losses, which were earned immediately.

The following table presents the ratios for the Reinsurance segment:

| | Six Months Ended June 30, | |
|-----------------------------|------------------------------|--------|
| | 2012 | 2011 |
| Loss and loss expense ratio | 47.8% | 80.0% |
| Acquisition expense ratio | 20.3% | 20.8% |
| Operating expense ratio | 9.3% | 11.2% |
| Underwriting expense ratio | 29.6% | 32.0% |
| Combined ratio | 77.4% | 112.0% |

The loss and loss expense ratio includes net losses incurred for both the current 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 the net (favorable) adverse prior year development relating to the Reinsurance segment for the six months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in millions, except ratios)</i> | Six Months Ended June 30, | |
|--|------------------------------|------------|
| | 2012 | 2011 |
| Property and other short-tail lines | \$ (40.6) | \$ (56.1) |
| Casualty and other | (44.2) | (72.2) |
| Total | \$ (84.8) | \$ (128.3) |
| Loss and loss expense ratio excluding prior year development | 57.6% | 96.2% |

Excluding prior year development, the loss ratio for the six months ended June 30, 2012 decreased by 38.6 loss percentage points as compared to the same period of 2011. Losses net of reinsurance recoveries and including reinstatement premiums recorded related to natural catastrophe events for the six months ended June 30, 2012 were \$11.2 million compared to \$309.9 million in the same period of 2011. For further details on catastrophe losses in 2011 see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Significant Items Affecting the Results of Operations 1) The impact of significant large natural catastrophe activity included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Excluding favorable prior year development, net catastrophe losses and related reinstatement premiums in both periods, the loss ratio for the six months ended June 30, 2012 and 2011 was the same at 56.2%.

Net favorable prior year reserve development of \$84.8 million for the six months ended June 30, 2012 was mainly attributable to the following:

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Net favorable prior year development of \$40.6 million for the short-tailed lines and details of these by specific lines are as follows:

For property catastrophe lines, net prior year development was \$0.4 million favorable.

For property other lines, net prior year development was \$22.4 million favorable mainly due to favorable attritional claim development on the North America and Bermuda books offset by some unfavorable attritional claim development on the Latin America book. Unfavorable development on a property facultative loss was offset by favorable subrogation on an older large loss.

For marine and aviation lines, net prior year development was \$17.8 million favorable due mainly to favorable attritional development together with releases on older large losses.

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Net favorable prior year development of \$44.2 million for the long-tailed lines and details of these by specific lines are as follows:

For casualty lines, net prior year development was \$35.3 million favorable arising mainly out of the North America book due to better than expected development on the 2003 and 2004 underwriting years.

For other lines, net prior year development was \$8.9 million favorable mainly driven by a release on the Structured Indemnity book.

The decrease in the underwriting expense ratio for the six months ended June 30, 2012 as compared to the same period of 2011 was due to a reduction in both the operating expense ratio of 1.9 points and the acquisition expense ratio of 0.5 points. The decrease in the operating expense ratio was due to lower compensation expenses in 2012 and reduced professional fees as compared to the same period of 2011. The decrease in the acquisition expense ratio was largely from decreased profit commissions paid as a result of lower net favorable prior year development in North America compared to the same period of 2011.

Net results from structured reinsurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these contracts have decreased in the six months ended June 30, 2012 as compared to the same period of 2011 due to higher interest expense. The higher interest expense was due to an accretion rate adjustment recorded in the current quarter based on changes in expected cash flows and payout patterns on one of the larger structured indemnity contracts and from lower net investment income in the six months ended June 30, 2012 reflecting lower investment yields and the run-off nature of this line of business.

Life Operations

The following table summarizes the contribution from the Life operations segment, which has been in run-off since 2009.

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|--|--------------------------------------|-------------|-----------------|
| | 2012 | 2011 | % change |
| Gross premiums written | \$ 179,587 | \$ 197,940 | (9.3)% |
| Net premiums written | 164,119 | 181,866 | (9.8)% |
| Net premiums earned | 164,143 | 181,901 | (9.8)% |
| Net losses and loss expenses | (252,457) | (270,647) | (6.7)% |
| Acquisition costs | (15,581) | (17,088) | (8.8)% |
| Operating expenses | (5,436) | (4,889) | 11.2% |
| Net investment income | 149,671 | 159,033 | (5.9)% |
| Net fee income and other | 90 | 137 | (34.3)% |
| Realized gains (losses) on investments | (14,403) | (38,847) | (62.9)% |
| Contribution from Life operations | \$ 26,027 | \$ 9,600 | *NM |

* NM - Not Meaningful

The following table is an analysis of the Life operations gross premiums written, net premiums written and net premiums earned for the six months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, 2012 | | | Six Months Ended June 30, 2011 | | |
|------------------------------------|---|-------------------------------------|------------------------------------|---|-------------------------------------|------------------------------------|
| | Gross Premiums Written | Net Premiums Written | Net Premiums Earned | Gross Premiums Written | Net Premiums Written | Net Premiums Earned |

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| | | | | | | | | | | | | |
|------------|----|---------|----|---------|----|---------|----|---------|----|---------|----|---------|
| Other Life | \$ | 102,767 | \$ | 101,418 | \$ | 101,443 | \$ | 116,027 | \$ | 114,975 | \$ | 115,010 |
| Annuity | | 76,820 | | 62,701 | | 62,700 | | 81,913 | | 66,891 | | 66,891 |
| Total | \$ | 179,587 | \$ | 164,119 | \$ | 164,143 | \$ | 197,940 | \$ | 181,866 | \$ | 181,901 |

Gross premiums written decreased in the six months ended June 30, 2012 as compared to the same period of 2011 by 9.3%, driven predominantly by the Other Life business. The decrease was in line with the run-off expectations combined with unfavorable foreign exchange movements. Ceded premiums written marginally decreased largely due to timing differences.

Net premiums earned decreased in the six months ended June 30, 2012 as compared to the same period of 2011 by 9.8%. This decrease was consistent with the decrease in gross and net premiums written as described above.

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Claims and policy benefit reserves decreased by 6.7% in the six months ended June 30, 2012 as compared to the same period of 2011, as a result of the factors noted above affecting gross and net premiums written, the impact of foreign exchange movements and claims volatility.

Acquisition costs decreased in the six months ended June 30, 2012 as compared to the same period of 2011 by 8.8%, mainly due to the impact of accrual adjustments in the prior year that were one-off in nature.

Operating expenses increased by 11.2% in the six months ended June 30, 2012 as compared to the same period in the prior year due to certain accrual adjustments in the prior year which lowered the expenses in that period.

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. Net investment income decreased by 5.9% in the six months ended June 30, 2012 as compared to the same period of 2011 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.

Investment Activities

The following table illustrates the change in 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 derivative instruments for the six months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|---|--------------------------------------|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net investment income - P&C operations (1) | \$ 378,202 | \$ 417,735 | (9.5)% |
| Net income (loss) from investment fund affiliates (2) | 22,505 | 37,400 | (39.8)% |
| Net realized gains (losses) on investments | 8,410 | (75,981) | *NM |
| Net realized and unrealized gains (losses) on investment and other derivative instruments (3) | (3,598) | (7,383) | 51.3% |

(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 in order for the Company to meet the filing deadlines for its periodic reports.

(3) For a summary of realized and unrealized gains and losses on all derivative instruments, see Item 1, Note 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

* NM - Not Meaningful

Net investment income related to P&C business decreased in the six months ended June 30, 2012 as compared to the same period of 2011 due primarily to a reduction in investment yields and cash outflows from the investment portfolio.

Net income from investment fund affiliates decreased in the six months ended June 30, 2012 as compared to the same period of 2011. This was driven by solid results from alternative fund affiliates in the first six months of 2012 as compared to strong results in the six months ended June 30, 2011 across both alternative and private fund affiliates.

The Company manages its fixed income portfolio in accordance with investment authorities approved by the Risk and Finance Committee of the Board of Directors of XL-Ireland. The following is a summary of the investment portfolio returns for the six months ended June 30, 2012 and 2011 of the fixed income and non-fixed income portfolios:

| | Six Months Ended June 30, | |
|------------------------------------|------------------------------|-------------|
| | 2012 (1) | 2011 (1) |
| Total Return on Investments | 2.9% | 2.4% |
| P&C fixed income portfolio | 2.6% | 2.5% |
| Life fixed income portfolio | 4.4% | 2.1% |
| Other Portfolios | | |
| Alternative portfolio (2) | 1.9% | 4.4% |
| Equity portfolio | 4.3% | 6.1% |
| High-Yield fixed income portfolio | 4.0% | 3.0% |

(1) Portfolio returns 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. The performance of investment portfolios are measured on a local currency basis. 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 the alternative portfolio reflects the three months ended May 31, 2012 and 2011, respectively.

Net Realized Gains and Losses on Investments and Other-than-Temporary Declines in the Value of Investments

Net realized gains on investments of \$8.4 million in the six months ended June 30, 2012 included net realized losses of approximately \$49.2 million related to the write-down of certain of the Company's AFS investments as well as losses arising on targeted sales of European financial exposures. In addition, included in the net realized gains noted above are net realized gains of \$57.6 million due primarily to gains from a repositioning of the Agency RMBS portfolio and net realized gains of \$33.8 million on sales of equity securities.

The significant components of the net impairment charges of \$49.2 million for the six months ended June 30, 2012 were:

\$31.3 million for structured securities where the Company 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.

\$13.2 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. The Company also adjusted the estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.

\$2.2 million related to currency losses primarily arising on U.K. sterling denominated securities held in U.S. dollar portfolios.

\$1.5 million related to equities as the holding was more than 50% impaired.

\$1.0 million for corporate securities, excluding medium term notes, principally on hybrid securities.

Net realized losses on investments during the six months ended June 30, 2011 included net realized losses of \$64.6 million related to the write-down of certain of the Company's fixed income, equity and other investments with respect to which the Company determined that there was an other-than-temporary decline in the value of those investments as well as \$11.4 million from sales of investments principally on European financials and non-Agency RMBS.

Net Realized and Unrealized Gains and Losses on Derivatives

Net realized and unrealized losses on derivatives of \$3.6 million in the six months ended June 30, 2012 resulted from the Company's 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 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

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Other Revenues and Expenses

The following table sets forth other revenues and expenses of the Company for the six months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|---|--------------------------------------|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net income (loss) from operating affiliates (1) | \$ 38,814 | \$ 59,887 | (35.2)% |
| Exchange gains (losses) | 5,258 | (1,016) | NM* |
| Corporate operating expenses | (94,321) | (75,258) | 25.3% |
| Interest expense (2) | (53,409) | (83,498) | (36.0)% |
| Income tax (benefit) expense | 51,362 | (7,971) | NM* |

(1) The Company generally records 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 structured products recorded in the Insurance and Reinsurance segments.

* NM Not meaningful

The following table sets forth the net income (loss) from operating affiliates for the six months ended June 30, 2012 and 2011:

| <i>(U.S. dollars in thousands)</i> | Six Months Ended June 30, | | |
|---|--------------------------------------|-------------|-----------------|
| | 2012 | 2011 | % change |
| Net income (loss) from financial operating affiliates | \$ - | \$ (1,018) | (100.0)% |
| Net income (loss) from investment manager affiliates | \$ 24,612 | \$ 46,512 | (47.1)% |
| Net income (loss) from strategic operating affiliates | 14,202 | 14,393 | (1.3)% |
| Total | \$ 38,814 | \$ 59,887 | (35.2)% |

The financial operating affiliate loss in the six months ended June 30, 2011 is wholly attributable to a write down in the value of one investment following a restructuring.

Investment manager affiliate income decreased in the six months ended June 30, 2012 as compared to the same period in the prior year due to especially strong performance by the investment manager affiliates and the achievement of results that surpassed certain fee hurdles by various funds under management in the second quarter of 2011, as compared to solid results for the investment manager affiliates in the six months ended June 30, 2012.

Strategic operating affiliate income for the six months ended June 30, 2012 was in line with the results for same period in the prior year.

Foreign exchange gains in the six months ended June 30, 2012 were a result of an overall strengthening of the value of the U.S. dollar against the Company's major currency exposures, which include the Euro and the Swiss franc. In the six months ended June 30, 2011, the foreign exchange losses were due to a weaker U.S. dollar against all of the Company's major currency exposures, particularly the Swiss franc and the Euro.

Corporate operating expenses increased in the six months ended June 30, 2012 as compared to the same period in the prior year primarily as a result of certain strategic corporate initiatives taking place in 2012.

Interest expense decreased in the six months ended June 30, 2012 as compared to the same period in the prior year as a result of the overall reduction in the Company's debt following the repayment at maturity on January 15, 2012 of \$600 million 6.5% XLCFE Notes, the purchase and retirement of the \$575 million 8.25% Senior Notes in August 2011, offset by the issuance 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, to the

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Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

A tax charge of \$51.4 million was incurred in the six months ended June 30, 2012. The Company recognized a tax benefit of \$8.0 million in the six months ended June 30, 2011, which included a benefit of \$11.9 million arising as a result of a change in an overseas tax rule adopted in the three months ended June 30, 2011. Excluding this benefit, the increase in the tax charge incurred in the six months ended June 30, 2012 compared to the same period of 2011 arose principally from higher income in taxable jurisdictions in the six months ended June 30, 2012.

BALANCE SHEET ANALYSIS**Investments**

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and build book value for the Company over the longer term. The strategy strives to balance investment returns against market and credit risk. The Company's overall investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance.

At both June 30, 2012 and December 31, 2011, total investments, cash and cash equivalents, accrued investment income and net receivable/(payable) for investments sold/(purchased) were approximately \$36 billion. The following table summarizes the composition of the Company's invested assets at June 30, 2012 and December 31, 2011:

| <i>(U.S. dollars in thousands)</i> | June 30, 2012 | | December 31, 2011 | |
|---|--------------------|------------------|--------------------|------------------|
| | Carrying Value (1) | Percent of Total | Carrying Value (1) | Percent of Total |
| Cash and cash equivalents | \$ 3,311,146 | 9.3% | \$ 3,825,125 | 10.7% |
| Net receivable/ (payable) for investments sold/ (purchased) | 5,866 | 0.0% | 1,233 | 0.0% |
| Accrued investment income | 323,898 | 0.9% | 331,758 | 0.9% |
| Short-term investments | 227,380 | 0.7% | 359,063 | 1.0% |
| Fixed maturities - AFS: | | | | |
| U.S. Government and Government-Related/Supported (2) | 2,101,625 | 5.9% | 1,990,983 | 5.5% |
| Corporate - Financials (3) (4) (5) | 2,809,953 | 7.9% | 3,038,398 | 8.5% |
| Corporate - Non Financials (4) | 6,911,200 | 19.4% | 7,070,224 | 19.7% |
| RMBS Agency | 5,202,313 | 14.6% | 5,379,406 | 15.0% |
| RMBS Non-Agency | 584,543 | 1.6% | 641,815 | 1.8% |
| CMBS | 904,792 | 2.6% | 974,835 | 2.8% |
| CDO | 650,018 | 1.8% | 658,602 | 1.8% |
| Other asset-backed securities (5) | 1,407,738 | 4.0% | 1,340,249 | 3.7% |
| U.S. States and political subdivisions of the States | 1,764,431 | 5.0% | 1,797,378 | 5.0% |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) | 3,906,189 | 11.0% | 3,298,135 | 9.2% |
| Total fixed maturities - AFS | \$ 26,242,802 | 73.8% | \$ 26,190,025 | 73.0% |
| Fixed maturities - HTM: | | | | |
| U.S. Government and Government-Related/Supported (2) | 10,458 | 0.0% | 10,399 | 0.0% |
| Corporate - Financials (3) (4) (5) | 257,713 | 0.7% | 305,122 | 0.9% |
| Corporate - Non Financials (4) | 1,129,320 | 3.2% | 985,087 | 2.7% |
| RMBS Non-Agency | 81,028 | 0.2% | 80,955 | 0.2% |
| CMBS | 12,546 | 0.0% | - | 0.0% |
| Other asset-backed securities (5) | 217,347 | 0.6% | 288,741 | 0.8% |
| Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) | 1,007,945 | 2.8% | 998,674 | 2.8% |
| Total fixed maturities - HTM | \$ 2,716,357 | 7.5% | \$ 2,668,978 | 7.4% |
| Equity securities (6) | 529,056 | 1.5% | 468,197 | 1.3% |
| Investments in affiliates | 1,024,353 | 2.9% | 1,052,729 | 2.9% |
| Other investments | 1,208,220 | 3.4% | 985,262 | 2.8% |
| Total investments and cash and cash equivalents | \$ 35,589,078 | 100.0% | \$ 35,882,370 | 100.0% |

(1) Carrying values represents the fair value for available for sale fixed maturities and amortized cost for held to maturity securities.

(2)

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- U.S. Government and Government-Related/Supported and Non U.S. Sovereign Government, Provincial, Supranational and Government-Related include government-related securities with an amortized cost of \$2,012.4 million and \$1,878.3 million and fair value of \$2,066.0 million and \$1,915.6 million at June 30, 2012 and December 31, 2011, respectively, and U.S. Agencies with an amortized cost of \$455.0 million and \$494.0 million and fair value of \$500.5 million and \$541.2 million at June 30, 2012 and December 31, 2011, respectively.
- (3) Included in Corporate Financials are gross unrealized losses of \$74.7 million and \$108.8 million on Tier One and Upper Tier Two securities of financial institutions (Hybrids) with fair value of \$346.2 million and \$386.1 million at June 30, 2012 and December 31, 2011, respectively, as well as gross unrealized losses of \$36.5 million and \$70.1 million on subordinated debt (including lower Tier Two securities) with a fair value of \$623.6 million and \$701.3 million at June 30, 2012 and December 31, 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 \$186.1 million and \$266.0 million and an amortized cost of \$199.1 million and \$297.7 million at June 30, 2012 and December 31, 2011, respectively. These securities have been allocated ratings of the underlying pool of securities. 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 June 30, 2012, Covered Bonds within Fixed maturities AFS with a carrying value of \$500.5 million and Covered Bonds within Fixed maturities HTM with a carrying value of \$8.1 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. At December 31, 2011, Covered Bonds within Fixed maturities AFS with a carrying

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value of \$353.9 million and Covered Bonds within Fixed maturities HTM with a carrying value of \$8.1 million have been 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 \$95.8 million and \$91.6 million at June 30, 2012 and December 31, 2011, respectively.

The Company reviews its corporate debt investments on a regular basis to consider its concentration, credit quality and compliance with established guidelines. At both June 30, 2012 and December 31, 2011, the average credit quality of the Company's 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 June 30, 2012 and December 31, 2011:

| Investments by Credit Rating (1) (2) (U.S. dollars in millions) | June 30, 2012 | | December 31, 2011 | |
|--|------------------|------------------|-------------------|------------------|
| | Carrying Value | Percent of Total | Carrying Value | Percent of Total |
| AAA | \$ 16,350 | 51.1% | \$ 16,276 | 51.1% |
| AA | 5,085 | 15.9% | 5,266 | 16.6% |
| A | 6,841 | 21.4% | 7,098 | 22.3% |
| BBB | 2,840 | 8.9% | 2,418 | 7.6% |
| BB and below | 826 | 2.6% | 718 | 2.3% |
| Not rated | 16 | 0.1% | 39 | 0.1% |
| Total | \$ 31,958 | 100.0% | \$ 31,815 | 100.0% |

- (1) At June 30, 2012 and December 31, 2011, \$186.1 million and \$266.0 million or 0.6% and 0.8% of the 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

The Company had gross unrealized losses totaling \$576.8 million on 1,308 securities out of a total of 7,156 held at June 30, 2012 in its AFS portfolio and \$12.5 million on 15 securities out of a total of 208 held in its HTM portfolio, which it considers to be temporarily impaired or with respect to which it reflects non-credit losses on OTTI. Individual security positions comprising this balance have been evaluated by management, in conjunction with its investments 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 \$165.6 million related to the Non-Agency RMBS portfolio (which consists of the Company's 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 \$665.6 million at June 30, 2012. The Company has incurred realized losses, consisting of charges for OTTI and realized losses from sales, of approximately \$1.4 billion since the beginning of 2007 through June 30, 2012 on these asset classes.

gross unrealized losses of \$163.8 million related to the Company's Life operations investment portfolio, which had a fair value of \$6.4 billion at June 30, 2012. Of these gross unrealized losses, \$88.4 million related to \$1.1 billion of exposures to corporate financial institutions, including \$281.1 million related to Tier One and Upper Tier Two securities.

At June 30, 2012, this portfolio had an average interest rate duration of 8.6 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

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unrealized losses related to this portfolio at June 30, 2012 by approximately \$280.0 million and \$107.8 million, respectively, on both the AFS and HTM Life operations investments portfolios.

Given the long term nature of the Life operations investments portfolio, the level of credit spreads on financial institutions at June 30, 2012 relative to historical averages within the U.K. and Euro-zone, and the Company's liquidity needs at June 30, 2012, the Company believes 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 \$154.1 million related to the P&C portfolios of Core CDO holdings (defined by the Company as investments in non-subprime CDOs), which consisted primarily of collateralized loan obligations (CLOs) and had a fair value of \$650.0 million at June 30, 2012.

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gross unrealized losses of \$73.8 million related to the corporate holdings within the Company's non-life fixed income portfolios, which had a fair value of \$7.7 billion at June 30, 2012. Of the gross unrealized losses, \$36.0 million relate to financial institutions. In addition, \$14.3 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 \$186.1 million at June 30, 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 is the maturity profile of the available for sale fixed income securities that were in a gross unrealized loss position at June 30, 2012:

| June 30, 2012 | | |
|---|--|--|
| <i>(U.S. dollars in thousands)</i> | Amount of Unrealized Loss | Fair Value of Securities in an Unrealized Loss Position |
| Security Type and Length of Time in a Continual Unrealized Loss Position | | |
| Fixed Maturities and Short-Term Investments | | |
| Less than 6 months | \$ (11,993) | \$ 918,383 |
| At least 6 months but less than 12 months | (14,305) | 376,786 |
| At least 12 months but less than 2 years | (45,969) | 327,766 |
| 2 years and over | (476,700) | 2,041,010 |
| Total | \$ (548,967) | \$ 3,663,945 |
| Equities | | |
| Less than 6 months | \$ (14,800) | \$ 319,720 |
| At least 6 months but less than 12 months | (13,071) | 102,484 |
| Total | \$ (27,871) | \$ 422,204 |

The following is the maturity profile of the AFS fixed income securities that were in a gross unrealized loss position at June 30, 2012:

| June 30, 2012 | | |
|---|--|--|
| <i>(U.S. dollars in thousands)</i> | Amount of Unrealized Loss | Fair Value of Securities in an Unrealized Loss Position |
| Maturity profile in years of AFS fixed income securities in a gross unrealized loss position | | |
| Less than 1 year remaining | \$ (9,616) | \$ 348,403 |
| At least 1 year but less than 5 years remaining (1) | (68,189) | 932,774 |
| At least 5 years but less than 10 years remaining (1) | (43,302) | 417,596 |
| At least 10 years but less than 20 years remaining (1) | (45,193) | 248,718 |
| At least 20 years or more remaining (1) | (27,139) | 186,723 |
| RMBS - Agency | (2,476) | 114,691 |
| RMBS - Non-Agency | (165,588) | 491,894 |
| CMBS | (4,068) | 44,941 |
| CDO | (154,095) | 640,745 |
| Other asset-backed securities | (29,301) | 237,460 |
| Total | \$ (548,967) | \$ 3,663,945 |

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- (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 and medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage are allocated on contractual maturity.

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The following is the maturity profile of the HTM fixed income securities that were in a gross unrealized loss position at June 30, 2012:

| <i>(U.S. dollars in thousands)</i> Maturity profile in years of HTM fixed income securities in a gross unrealized loss position | Amount of Unrealized Loss | Fair Value of Securities in an Unrealized Loss Position |
|---|----------------------------------|--|
| Less than 1 year remaining | \$ - | \$ - |
| At least 1 year but less than 5 years remaining | (307) | 8,935 |
| At least 5 years but less than 10 years remaining | (647) | 21,291 |
| At least 10 years but less than 20 years remaining | (4,928) | 24,599 |
| At least 20 years or more remaining | (6,139) | 47,108 |
| RMBS - Non-Agency | (15) | 4,996 |
| Other asset-backed securities | (464) | 8,972 |
| Total | \$ (12,500) | \$ 115,901 |

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, 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 Unaudited Consolidated Financial Statements included herein.

As noted in Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, 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 the Company's results of operations. There can be no assurance that management has accurately assessed the level of OTTI taken and reflected in the Company's 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 the Company's assessment of the intent to sell securities that have declined in value prior to recovery. If, due to changes in circumstances, the Company determines to reposition or realign portions of the portfolio and the Company determines not to hold certain securities in an unrealized loss position to recovery, then the Company will incur OTTI charges, which could be significant.

Gross Unrealized Gains and Losses

Management, in its assessment of whether securities in a gross unrealized loss position are temporarily impaired, considers the significance of the impairments. These securities include gross unrealized losses of \$165.6 million on non-Agency RMBS, \$154.1 million on Core CDOs and \$4.1 million on CMBS holdings. At June 30, 2012, the Company had structured credit securities with gross unrealized losses of \$55.2 million, which had a fair value of \$26.3 million and a cumulative fair value decline of greater than 50% of amortized costs. All of these are mortgage- and asset-backed securities. The Company has evaluated each of these securities in conjunction with its investment manager service providers and believes 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 June 30, 2012, approximately \$1.1 billion of the Company's \$3.1 billion in corporate financial sector securities was held in the portfolios supporting the Company's Life operations portfolios representing 71.1% of the gross unrealized losses 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 the Company's 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 Life operations portfolios accounted for \$71.0 million of the Company's net unrealized loss at June 30, 2012. At June 30, 2012, approximately 42.7% of the overall sensitivity to interest rate risk and 35.1% to credit risk

was related to the Life operations portfolios, despite these portfolios accounting for only 20.2% of the fixed income portfolio.

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Net Unrealized Gains and Losses Structured Securities

The following table details the current exposures to structured credit portfolios excluding Agency RMBS within the Company's fixed income portfolio as well as the current net unrealized (loss) gain position at June 30, 2012 and December 31, 2011:

| <i>(U.S. dollars in thousands)</i> | June 30, 2012 | | | December 31, 2011 | | |
|---|---------------------|-----------------------------------|----------------------------|---------------------|-----------------------------------|----------------------------|
| | Carrying Value | Percent of Fixed Income Portfolio | Net Unrealized Gain (Loss) | Carrying Value | Percent of Fixed Income Portfolio | Net Unrealized Gain (Loss) |
| RMBS - Non-Agency: | | | | | | |
| Sub-prime first lien mortgages | \$ 267,772 | 0.9% | \$ (100,363) | \$ 295,498 | 1.0% | \$ (136,981) |
| Alt-A mortgages | 125,323 | 0.4% | (25,056) | 114,506 | 0.4% | (39,659) |
| Second lien mortgages (including sub-prime second lien mortgages) | 25,728 | 0.1% | (3,217) | 26,461 | 0.1% | (6,076) |
| Prime RMBS | 133,425 | 0.5% | (15,385) | 158,264 | 0.5% | (26,328) |
| Other assets | 113,323 | 0.4% | 255 | 128,041 | 0.4% | 5,790 |
| Total exposure to Non-Agency RMBS | \$ 665,571 | 2.3% | \$ (143,766) | \$ 722,770 | 2.4% | \$ (203,254) |
| CMBS | 917,338 | 3.2% | 61,990 | 974,835 | 3.3% | 47,152 |
| Core CDOs (1) | 650,018 | 2.2% | (146,000) | 662,949 | 2.3% | (185,611) |
| Other Structured | 1,625,085 | 5.6% | 15,673 | 1,635,162 | 5.6% | 7,732 |
| Total Non-Agency Structured Securities | \$ 3,858,012 | 13.3% | \$ (212,103) | \$ 3,995,716 | 13.6% | \$ (333,981) |

(1) The Company defines Core CDOs as investments in non-subprime collateralized debt obligations, which primarily consisted of CLOs.

At June 30, 2012, the Company's sub-prime, Alt-A and CDO exposures had adequate underlying asset characteristics and the Company believed 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. The Company had approximately \$63.3 million of Non-Agency RMBS downgraded during the three months ended June 30, 2012. However, 56.3% of the Company's holdings in Non-Agency RMBS remain rated investment grade at June 30, 2012.

Refer to Significant Items Affecting the Results of Operations for further discussion surrounding the impact of credit market movements on the Company's 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.

The Company's 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. The Company continues to monitor its financial exposure to this crisis, and continually assesses 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. With regard to non-sovereign securities, the Company considers a security to be at risk if the security

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issuer's main operations are physically located within GIIPS, as opposed to where the issuer is legally domiciled.

The Company currently has no unfunded investment exposures or commitments to either sovereign or non-sovereign entities within these EU nations. The Company does 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 the Company's AFS and HTM fixed maturity investment exposures related to this GIIPS crisis at June 30, 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.

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| | June 30, 2012 | | December 31, 2011 | |
|--|-------------------|-------------------|-------------------|-------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| <i>(U.S. dollars in thousands)</i> | | | | |
| Fixed maturities GIIPS - AFS | | | | |
| Sovereign investments National Governments | \$ 5,368 | \$ 4,730 | \$ 6,601 | \$ 5,927 |
| Non-Sovereign investments Financial Institutions | 372 | 325 | 6,001 | 4,626 |
| Non-Sovereign investments Non-Financial Institutions | 112,581 | 106,122 | 138,834 | 131,890 |
| Structured Credit (1) | 10,647 | 11,077 | 22,172 | 19,417 |
| Total fixed maturities GIIPS - AFS | \$ 128,968 | \$ 122,254 | \$ 173,608 | \$ 161,860 |
| Due less than one year | \$ 12,283 | \$ 12,542 | \$ 13,824 | \$ 14,028 |
| Due after 1 through 5 years | 30,908 | 29,556 | 32,992 | 31,050 |
| Due after 5 through 10 years | 49,346 | 48,635 | 72,988 | 70,651 |
| Due after 10 years | 36,431 | 31,521 | 53,804 | 46,131 |
| | \$ 128,968 | \$ 122,254 | \$ 173,608 | \$ 161,860 |
| Fixed maturities GIIPS - HTM | | | | |
| Sovereign investments National Governments | \$ 11,828 | \$ 8,725 | \$ 11,738 | \$ 8,739 |
| Sovereign investments Local Governments | - | - | 9,360 | 7,649 |
| Non-Sovereign investments Non-Financial Institutions | 63,844 | 55,778 | 72,782 | 65,380 |
| Total fixed maturities GIIPS - HTM | \$ 75,672 | \$ 64,503 | \$ 93,880 | \$ 81,768 |
| Due less than one year | \$ 6,199 | \$ 6,208 | \$ 6,264 | \$ 6,233 |
| Due after 1 through 5 years | 4,187 | 4,038 | 4,199 | 4,110 |
| Due after 5 through 10 years | 12,017 | 11,960 | 20,705 | 18,260 |
| Due after 10 years | 53,269 | 42,297 | 62,712 | 53,165 |
| Total | \$ 75,672 | \$ 64,503 | \$ 93,880 | \$ 81,768 |

(1) During 2012, Covered Bonds have been included within Other asset-backed securities under Structured Credit to align the Company's 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 June 30, 2012 relating to GIIPS:

| | June 30, 2012 | | | | | |
|--|---------------|------------|---------|----------|---------|------------|
| | Greece | Italy | Ireland | Portugal | Spain | TOTAL |
| <i>(U.S. dollars in thousands)</i> | | | | | | |
| Gross Unrealized (Losses) - GIIPS | | | | | | |
| Sovereign investments National Governments | \$ - | \$ (3,741) | \$ - | \$ - | \$ - | \$ (3,741) |
| Sovereign investments Local Governments | - | - | - | - | - | - |
| Non-Sovereign investments Financial Institutions | - | - | (47) | - | - | (47) |
| Non-Sovereign investments Non-Financial Institutions | (37) | (9,468) | - | - | (7,540) | (17,045) |
| Structured Credit (1) | - | (1,127) | - | - | - | (1,127) |

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| | | | | | | | | | | | | |
|---|----|------|----|----------|----|------|----|---|----|---------|----|----------|
| Total gross unrealized gains (losses) relating to GIIPS | \$ | (37) | \$ | (14,336) | \$ | (47) | \$ | - | \$ | (7,540) | \$ | (21,960) |
|---|----|------|----|----------|----|------|----|---|----|---------|----|----------|

Net Unrealized Gains (Losses) - GIIPS

| | | | | | | | | | | | | | |
|---------------------------|----------------------------|-----|---------|-------|-------|---------|---------|----|---|----|---|------|-------|
| Sovereign investments | National Governments | \$ | - | \$ | (638) | \$ | - | \$ | - | \$ | - | \$ | (638) |
| Sovereign investments | Local Governments | - | - | - | - | - | - | - | - | - | - | - | |
| Non-Sovereign investments | Financial Institutions | - | - | (47) | - | - | - | - | - | - | - | (47) | |
| Non-Sovereign investments | Non-Financial Institutions | 254 | (2,369) | - | - | (4,344) | (6,459) | | | | | | |
| Structured Credit (1) | | - | (1,127) | 1,557 | - | - | 430 | | | | | | |

| | | | | | | | | | | | | |
|---|----|-----|----|---------|----|-------|----|---|----|---------|----|---------|
| Total net unrealized gains (losses) relating to GIIPS | \$ | 254 | \$ | (4,134) | \$ | 1,510 | \$ | - | \$ | (4,344) | \$ | (6,714) |
|---|----|-----|----|---------|----|-------|----|---|----|---------|----|---------|

(1) Covered Bonds have been included within Other asset-backed securities under Structured Credit to align the Company's 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 the Company within unpaid losses and loss expenses recoverable and reinsurance balances receivable. For further details on these balances including the names of the Company's most significant reinsurance counterparties, see Item 8, Note 9, Reinsurance, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. 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 the Company has an interest. Management considers these potential exposures as part of its ongoing enterprise risk management processes.

Fair Value Measurements of Assets and Liabilities

As described in Item 1, Note 3, *Fair Value Measurements*, to the Unaudited Consolidated Financial Statements included herein, effective January 1, 2008, the Company adopted the authoritative guidance on fair value measurements and, accordingly, has provided required disclosures by level within the fair value hierarchy of the Company's 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 the Company's Level 3 assets and liabilities. The vast majority of the assets and liabilities classified as Level 3 are made up of those securities for which the values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not obtained to support a Level 2 classification or the Company utilized internal valuation models.

Controls over Valuation of Financial Instruments

The Company performs regular reviews of the prices received from its third party valuation sources to assess if 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 taken by the Company include, but are not limited to, annual reviews of the controls of the external parties responsible for sourcing valuations which are subjected to automated tolerance checks, quarterly reviews of the valuation sources and dates, 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, the Company assesses the effectiveness of valuation controls performed by external parties responsible for sourcing appropriate valuations from third parties on the Company's 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. The Company obtains 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, 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.

Valuation Methodology of Level 3 Assets and Liabilities

Refer to Item 1, Note 3, *Fair Value Measurements*, of the Unaudited 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 June 30, 2012, the Company 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 June 30, 2012.

Fair Value of Level 3 Assets and Liabilities

At June 30, 2012, the fair value of Level 3 assets and liabilities as a percentage of the Company's total assets and liabilities that are carried at fair value was as follows:

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(U.S. dollars in thousands)

| | Total Assets and Liabilities Carried at Fair Value at June 30, 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 | \$ 2,101,625 | \$ - | 0.0% |
| Corporate (1) | 9,721,153 | 33,511 | 0.3% |
| RMBS Agency | 5,202,313 | 52,588 | 1.0% |
| RMBS Non-Agency | 584,543 | 1,596 | 0.3% |
| CMBS | 904,792 | - | 0.0% |
| CDO | 650,018 | 642,179 | 98.8% |
| Other asset-backed securities (1) | 1,407,738 | 25,248 | 1.8% |
| U.S. States and political subdivisions of the States | 1,764,431 | - | 0.0% |
| Non-U.S. Sovereign Government, Supranational and Government-Related | 3,906,189 | - | 0.0% |
| Total Fixed maturities, at fair value | \$ 26,242,802 | \$ 755,122 | 2.9% |
| Equity securities, at fair value | 529,056 | - | 0.0% |
| Short-term investments, at fair value | 227,380 | - | 0.0% |
| Total investments available for sale | \$ 26,999,238 | \$ 755,122 | 2.8% |
| Cash equivalents (2) | 2,461,281 | - | 0.0% |
| Other investments (3) | 894,203 | 117,765 | 13.2% |
| Other assets (4) | 53,430 | - | 0.0% |
| Total assets carried at fair value | \$ 30,408,152 | \$ 872,887 | 2.9% |
| Liabilities | | | |
| Financial instruments sold, but not yet purchased (5) | \$ 28,198 | \$ - | 0.0% |
| Other liabilities (6) | 46,525 | 35,947 | 77.3% |
| Total liabilities carried at fair value | \$ 74,723 | \$ 35,947 | 48.1% |

- (1) During 2012, Covered Bonds previously included as Corporate securities are now classified as Other asset-backed securities to align the Company's classification to market indices. At June 30, 2012, these securities had a fair value of \$500.5 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 in the Company's Annual Report on Form 10-K for the year ended December 31, 2011) 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 \$314.0 million at June 30, 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 Net payable for investments purchased on the balance sheet.
- (6) Other liabilities include derivative instruments, reported on a gross basis.

At June 30, 2012, the Company's Level 3 assets represented approximately 2.9% of assets that are measured at fair value and less than 2% of total assets. The Company's Level 3 liabilities represented approximately 48.1% of liabilities that are measured at fair value and less than 1% of total liabilities at June 30, 2012.

Changes in the Fair Value of Level 3 Assets and Liabilities

See Item 1, Note 3, Fair Value Measurements, to the Unaudited 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

The Company establishes 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. The Company's reserving practices and the establishment of any particular reserve reflects management's judgment concerning sound financial practice and do not represent any admission of liability with respect to any claims made against the Company.

Unpaid losses and loss expenses totaled \$20.0 billion and \$20.6 billion at June 30, 2012 and December 31, 2011, respectively. The table below represents a reconciliation of the Company's P&C unpaid losses and loss expenses for the six months ended June 30, 2012:

| <i>(U.S. dollars in thousands)</i> | 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 | 2,000,688 | (320,268) | 1,680,420 |
| Losses and loss expenses paid/recovered | (2,555,355) | 625,458 | (1,929,897) |
| Foreign exchange and other | (97,284) | 3,299 | (93,985) |
| Balance at June 30, 2012 | \$ 19,961,950 | \$ (3,321,439) | \$ 16,640,511 |

While the Company reviews the adequacy of established reserves for unpaid losses and loss expenses regularly, 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 in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable

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. While reinsurance agreements are designed to limit the Company's losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve the Company of its ultimate liability to the Company's insureds. Accordingly, the losses and loss expense reserves on the balance sheet represent the Company's total unpaid gross losses. Unpaid losses and loss expense recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

Unpaid losses and loss expense recoverables were \$3.3 billion and \$3.7 billion at June 30, 2012 and December 31, 2011, respectively. At both June 30, 2012 and December 31, 2011, reinsurance balances receivable were \$0.2 billion. The table below presents the Company's net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable at June 30, 2012 and December 31, 2011.

| | June 30, 2012 | December 31, 2011 |
|---|--------------------------|----------------------------------|
| Reinsurance balances receivable | \$ 261,795 | \$ 263,877 |
| Reinsurance recoverable on future policy benefits | 21,189 | 25,020 |
| Reinsurance recoverable on unpaid losses and loss expenses | 3,381,381 | 3,685,260 |
| Bad debt reserve on unpaid losses and loss expenses recoverable and reinsurance balances receivable | (98,550) | (99,192) |
| Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable | \$ 3,565,815 | \$ 3,874,965 |

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of the Company's ability to generate sufficient cash flows to meet the short and long-term cash requirements of the Company's business operations. As a global insurance and reinsurance company, one of the Company's principal responsibilities to its clients is to ensure that the Company has ready access to funds with which to settle large unforeseen claims. The Company 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 the Company due to extraordinary events and, as such, the Company's 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 the Company's core insurance and reinsurance subsidiaries that would require posting of collateral in connection with the Company's 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), etc. Any one or a combination of such events may cause a liquidity strain for the Company. 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, given 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 the Company's 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 (Stable) and the A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger cancellation provisions in a significant amount of the Company's assumed reinsurance agreements and may potentially require the Company to return unearned premiums to cedants. In addition, due to collateral posting requirements under the Company's 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 the Company's three largest credit facilities and may trigger such collateral requirements. In certain limited instances, such downgrades may require the Company to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1A, Risk Factors, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

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.

As holding companies, XL-Ireland's and XL-Cayman's future cash flows largely depend on the availability of dividends or other statutorily permissible payments from subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries and states in which these subsidiaries operate, including, among others, the Cayman Islands, Bermuda, the United States, New York, Ireland, Switzerland and the U.K. See Item 8, Note 23, Statutory Financial Data, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further discussion and details regarding the dividend capacity of the Company's 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, in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The ability to pay such dividends is also limited by the regulations of the Society of Lloyd's and certain contractual provisions. No assurance can be given that the Company's 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 the Company to have the ability 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 June 30, 2012, XL-Ireland had \$3.8 billion in distributable reserves.

During 2009, management changed the internal ownership structure of certain of the Company's operating subsidiaries in Bermuda and Ireland in order to more efficiently utilize capital and to improve overall liquidity. In connection with these changes,

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certain dividends were paid to XL-Cayman by operating subsidiaries. At June 30, 2012, XL-Ireland and XL-Cayman held cash and investments, net of liabilities associated with cash sweeping arrangements, of \$(8.8) million and \$1.2 billion, respectively, compared to \$1.6 million and \$2.0 billion, respectively, at December 31, 2011.

All outstanding debt of the Company at June 30, 2012 and December 31, 2011 was issued by XL-Cayman except for the \$600 million 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 wholly-owned subsidiaries of XL-Ireland. XL-Cayman's outstanding debt is fully and unconditionally guaranteed by XL-Ireland. The Company's ability 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 the Company operates, including, among others, Bermuda, the United States, Ireland, Switzerland and the U.K. At December 31, 2011, required statutory capital and surplus for the principal operating subsidiaries of the Company was \$6.7 billion.

XL-Ireland and its subsidiaries provide no guarantees or other commitments (express or implied) of financial support to the Company's subsidiaries or affiliates, except for such guarantees or commitments that are in writing.

See also the Unaudited Consolidated Statements of Cash Flows in Item 1, Financial Statements included herein.

Sources of Liquidity for the Company

At June 30, 2012, the consolidated Company had cash and cash equivalents of approximately \$3.3 billion as compared to approximately \$3.8 billion at December 31, 2011. There are three main sources of cash flows for the Company—those provided by operations, investing activities and financing activities.

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 the Company's subsidiaries and to fund dividends to XL-Ireland. Cash receipts from operations is generally derived from the receipt of investment income on the Company's investment portfolio as well as the net receipt of premiums less claims and expenses related to the Company's underwriting activities in its P&C operations as well as its Life operations segment. The Company's 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 six months ended June 30, 2012, net cash flows provided by operating activities were \$483.6 million compared to net cash flows provided by operating activities of \$107.3 million for the same period in 2011. The operating cash increase was primarily due to the increase in net income in the six months ended June 30, 2012 compared to the same period in the prior year.

Investing Cash Flows

Generally, positive cash flow from operations and financing activities is invested in the Company's investment portfolio, including affiliates or the acquisition of subsidiaries.

Net cash used in investing activities was \$5.5 million in the six months ended June 30, 2012 compared to net cash provided of \$84.4 million for the same period in 2011. These cash flows were associated with the normal purchase and sale of portfolio investments.

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. As further outlined in Item 1, Note 5, Investments Pledged Assets, to the Unaudited Consolidated Financial Statements included herein, certain assets of the investment portfolio are collateralized for the Company's letter of credit facilities. At June 30, 2012 and December 31, 2011, the Company had \$17.5 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 six months ended June 30, 2012, net cash flows used in financing activities were \$988.4 million. Net cash outflows related primarily to the buybacks of the Company's ordinary shares and repayment of debt as described below.

On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to \$750 million of its 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 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares, respectively, under the new program for \$100.0 million and \$125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company's constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, \$525.0 million remained available for purchase under the new 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 8, Notes Payable and Debt Financing Arrangements, to the Unaudited Consolidated Financial Statements included herein.

In addition, the Company maintains credit facilities that provide liquidity. Details of these facilities are described below in Capital Resources.

Capital Resources

At June 30, 2012 and December 31, 2011, the Company had total shareholders' equity of \$11.2 billion and \$10.8 billion, respectively. In addition to ordinary share capital, the Company depends 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, the Company requires, 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 the Company's 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 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. The Company 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 the Company's requirement to renew its credit facilities:

the credit available from banks may be reduced resulting in the Company's need to pledge its investment portfolio to customers. This could result in a lower investment yield;

the Company may be downgraded by one or more rating agencies, which could materially and negatively impact the Company's business, financial condition, results of operations and/or liquidity; and

the volume of business that the Company's subsidiaries that are not admitted in the United States are able to transact could be reduced if the Company is 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 the Company being reduced. The Company attempts 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, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The following table summarizes the components of the Company's current capital resources at June 30, 2012 and December 31, 2011:

| <i>(U.S. dollars in thousands)</i> | June 30, 2012 | December 31, 2011 |
|--|--------------------------|----------------------------------|
| Series D preference ordinary shares | \$ 345,000 | \$ 345,000 |
| Series E preference ordinary shares | 999,500 | 999,500 |
| Ordinary share capital | 9,867,809 | 9,411,658 |
| Total ordinary and non-controlling interests capital | \$ 11,212,309 | \$ 10,756,158 |
| Notes payable and debt | 1,665,293 | 2,264,618 |
| Total capital | \$ 12,877,602 | \$ 13,020,776 |

Ordinary Share Capital

The following table reconciles the opening and closing ordinary share capital positions at June 30, 2012 and December 31, 2011:

| <i>(U.S. dollars in thousands)</i> | June 30, 2012 | December 31, 2011 |
|---|--------------------------|----------------------------------|
| Ordinary shareholders' equity beginning of period | \$ 9,411,658 | \$ 9,597,473 |
| Net income (loss) attributable to XL Group plc | 397,784 | (474,760) |
| Share buybacks | (225,978) | (667,022) |
| Share issues | 1,385 | 573,015 |
| Ordinary share dividends | (68,755) | (138,978) |
| Change in accumulated other comprehensive income | 327,696 | 482,269 |
| Share based compensation and other | 24,019 | 39,661 |
| Ordinary shareholders' equity end of period | \$ 9,867,809 | \$ 9,411,658 |

Debt

The following tables present the Company's debt under outstanding securities and lenders' commitments at June 30, 2012:

| <i>(U.S. dollars in thousands)</i> | Payments Due by Period | | | | | | |
|------------------------------------|-------------------------------|--------------------------------|---------------------------|---------------------------------|-------------------------|-------------------------|--------------------------|
| | Commitment/ Debt | In Use/ Outstanding | Year of Expiry | Less than 1 Year | 1 to 3 Years | 3 to 5 Years | After 5 Years |
| 4-year revolver | \$ 1,000,000 | \$ - | 2015 | \$ - | \$ - | \$ - | \$ - |
| 5.25% Senior Notes | 600,000 | 597,963 | 2014 | - | 600,000 | - | - |
| 5.75% Senior Notes | 400,000 | 396,014 | 2021 | - | - | - | 400,000 |
| 6.375% Senior Notes | 350,000 | 348,646 | 2024 | - | - | - | 350,000 |
| 6.25% Senior Notes | 325,000 | 322,670 | 2027 | - | - | - | 325,000 |
| | \$ 2,675,000 | \$ 1,665,293 | | \$ - | \$ 600,000 | \$ - | \$ 1,075,000 |

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| | |
|--|--------------|
| Adjustment to carrying value - impact of fair value hedges | \$ 8,628 |
| Total | \$ 1,673,921 |

In Use/Outstanding data represent June 30, 2012 accreted values. Payments Due by Period data represent ultimate redemption values.

In addition, see Item 1, Note 13, Notes Payable and Debt and Financing Arrangements, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information.

At June 30, 2012, banks and investors provided the Company and its subsidiaries with \$2.7 billion of debt capacity, of which \$1.7 billion was utilized by the Company. These facilities consist of:

a revolving credit facility of \$1.0 billion.

senior unsecured notes of approximately \$1.7 billion. These notes require the Company to pay a fixed rate of interest during their terms. At June 30, 2012, there were four outstanding issues of senior unsecured notes:

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\$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 were \$589.6 million. Related expenses of the offering amounted to \$4 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 \$395.8 million. Related expenses of the offering amounted to \$4.2 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 \$348 million. Related expenses of the offering amounted to \$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 the consolidated financial statements of the Company 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 in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information. During the third quarter of 2011, all Redeemable Series C preference ordinary shares were purchased and canceled. At June 30, 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. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Contingent Capital in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information.

On December 5, 2011, the Company 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, the Company 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 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 June 30, 2012, the Company had five letter of credit (LOC) facilities in place with total availability of \$4.0 billion, of which \$1.7 billion was utilized.

| <i>(U.S. dollars in thousands)</i> | Amount of Commitment Expiration by Period | | | | | | |
|------------------------------------|--|--------------------------------|---------------------------|---------------------------------|-------------------------|-------------------------|--------------------------|
| | Commitment/ Debt | In Use/ Outstanding | Year of Expiry | Less than 1 Year | 1 to 3 Years | 3 to 5 Years | After 5 Years |
| LOC Facility (1) | \$ 1,000,000 | \$ 798,046 | \$ 2014 | \$ - | \$ 798,046 | \$ - | \$ - |
| LOC Facility (2) (3) | 1,350,000 | 116,664 | 2015 | - | - | 116,664 | - |
| LOC Facility (3) | 650,000 | 371,690 | 2015 | - | - | 371,690 | - |
| LOC Facility | 750,000 | 316,674 | Continuous | - | - | - | 316,674 |
| LOC Facility | 250,000 | 125,874 | Continuous | - | - | - | 125,874 |
| Five LOC facilities | \$ 4,000,000 | \$ 1,728,948 | | \$ - | \$ 798,046 | \$ 488,354 | \$ 442,548 |

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- (1) The Company has 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 Notes Payable and Debt.
- (3) The Company has 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, the Company and certain of its subsidiaries (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.

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On March 25, 2011, the Company and certain of its subsidiaries 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, the Company and certain of its subsidiaries 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. The Company has 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, the Company could be required to provide alternative security to cedants. This could take the form of insurance trusts supported by the Company's investment portfolio or funds withheld (amounts retained by ceding companies to collateralize loss or premium reserves) using the Company's 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 business written by the Company and the loss experience of such business. In addition to letters of credit, the Company has established insurance trusts in the United States that provide cedants with statutory credit for reinsurance under state insurance regulation in the United States.

The Company reviews current and projected collateral requirements on a regular basis, as well as new sources of collateral. Management's objective is to maintain an excess amount of collateral sources over expected uses. The Company also reviews its liquidity needs on a regular basis.

In October 2011, the \$75,000 letter of credit facility that was supporting a subsidiary of the Company terminated.

Other

For information regarding cross-default and certain other provisions in the Company's debt and convertible securities documents, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Cross-Default and Other Provisions in Debt Instruments, in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and the Company's Current Report on Form 8-K filed on March 28, 2011.

See Part II, Item 2, Unregistered Sales of Equity Securities and Use of Proceeds, below.

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, the Company s Annual Report to ordinary shareholders, any proxy statement, any Form 10-K, Form 10-Q or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward-looking statements that reflect the Company s current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to the Company 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 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. The Company believes that these factors include, but are not limited to, the following: (i) changes in the size of the Company s 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; (ii) trends in rates for property and casualty insurance and reinsurance; (iii) the timely and full recoverability of reinsurance placed by the Company with third parties, or other amounts due to the Company; (iv) changes in ratings, rating agency policies or practices; (v) changes in the projected amount of ceded reinsurance recoverables and the ratings and creditworthiness of reinsurers; (vi) the timing of claims payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company; (vii) the Company s ability to successfully implement its business strategy especially during a soft market cycle; (viii) increased competition on the basis of pricing, capacity, coverage terms or other factors, which could harm the Company s ability to maintain or increase its business volumes or profitability; (ix) greater frequency or severity of claims and loss activity than the Company s underwriting, reserving or investment practices anticipate based on historical experience or industry data; (x) changes in general economic conditions, including the effects of inflation on the Company s 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 the Company s investments or access to such markets; (xi) developments, including uncertainties related to 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; (xii) the potential impact on the Company from government-mandated insurance coverage for acts of terrorism; (xiii) the potential for changes to methodologies, estimations and assumptions that underlie the valuation of the Company s financial instruments that could result in changes to investment valuations; (xiv) changes to the Company s assessment as to whether it is more likely than not that the Company will be required to sell, or has the intent to sell, available for sale debt securities before their anticipated recovery; (xv) the availability of borrowings and letters of credit under the Company s credit facilities; (xvi) the ability of the Company s subsidiaries to pay dividends to XL Group plc and XLIT Ltd.; (xvii) the potential effect of regulatory developments in the jurisdictions in which the Company operates, including those which could impact the financial markets or increase the Company s business costs and required capital levels; (xviii) changes in regulations or laws applicable to XL Group plc or its subsidiaries, brokers or customers; (xix) acceptance of the Company s products and services, including new products and services; (xx) changes in the availability, cost or quality of reinsurance; (xxi) changes in the distribution or placement of risks due to increased consolidation of insurance and reinsurance brokers; (xxii) loss of key personnel; (xxiii) changes in accounting policies or practices or the application thereof; (xxiv) legislative or regulatory developments including, but not limited to, changes in regulatory capital balances that must be maintained by the Company s operating subsidiaries and governmental actions for the purpose of stabilizing the financial markets; (xxv) the effects of mergers, acquisitions and divestitures; (xvi) developments related to bankruptcies of companies insofar as they affect property and casualty insurance and reinsurance coverages or claims that the Company may have as a counterparty; (xxvii) changes in applicable tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof; (xxviii) the effects of business disruption or economic contraction due to war, terrorism or other hostilities; (xxix) the Company s ability to realize the expected benefits from the redomestication; and (xxx) the other factors set forth in Item 1A, Risk Factors, and the Company s 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. The Company undertakes 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.

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ANNUALIZED RETURN ON ORDINARY SHAREHOLDERS' EQUITY CALCULATION

The following is a reconciliation of the Company's annualized return on ordinary shareholders' equity for the three and six months ended June 30, 2012 and 2011 to annualized net income (loss) attributable to ordinary shareholders:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------------|------------------------------|---------------|
| | 2012 | 2011 | 2012 | 2011 |
| <i>(U.S. dollars in thousands, except percentages)</i> | | | | |
| Opening shareholders' equity | \$ 11,054,489 | \$ 10,255,716 | \$ 10,756,130 | \$ 10,599,769 |
| Less: Non-controlling interest in equity of consolidated subsidiaries | (1,344,467) | (1,001,798) | (1,344,472) | (1,002,296) |
| Opening ordinary shareholders' equity | \$ 9,710,022 | \$ 9,253,918 | \$ 9,411,658 | \$ 9,597,473 |
| Closing shareholders' equity | 11,213,802 | 10,614,451 | 11,213,802 | 10,614,451 |
| Less: Non-controlling interest in equity of consolidated subsidiaries | (1,345,993) | (1,001,781) | (1,345,993) | (1,001,781) |
| Closing ordinary shareholders' equity | \$ 9,867,809 | \$ 9,612,670 | \$ 9,867,809 | \$ 9,612,670 |
| Average ordinary shareholders' equity | 9,788,915 | 9,433,294 | 9,639,733 | 9,605,071 |
| Net income (loss) attributable to ordinary shareholders | 221,156 | 225,663 | 397,784 | (1,621) |
| Annualized net income (loss) attributable to ordinary shareholders | 884,624 | 902,652 | 795,568 | (3,242) |
| Annualized return on ordinary shareholders' equity - Net income (loss) attributable to ordinary shareholders | 9.0% | 9.6% | 8.3% | 0.0% |

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

The following discussion should be read in conjunction with Quantitative and Qualitative Disclosures about Market Risk, presented under Item 7A, Quantitative and Qualitative Disclosures About Market Risk, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Market risk represents the potential for loss due to adverse changes in the fair value of financial and other instruments. The Company is principally exposed to the following market risks: interest rate risk, foreign currency exchange rate risk, equity price risk, credit risk, and other related market risks.

The majority of the Company's market risk arises from its 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. The Company's 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 credit, 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, equity prices and other related market instruments affect consolidated net income when, and if, a security is sold or impaired.

The Company may enter into derivatives and other financial instruments primarily for risk management purposes. For example, the Company may use derivatives to hedge foreign exchange and interest rate risk related to its consolidated net exposures. From time to time, the Company 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, the Company entered into credit derivatives outside of the investment portfolio in conjunction with the legacy financial guarantee and financial products operations. The Company attempts 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 6, Derivative Instruments, to the Unaudited 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 the Company's investment portfolio. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events or losses. See Item 2, 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. The Company's fixed income portfolio is exposed to interest rate risk. The Company's 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 its Strategic Asset Allocation (SAA) process by specifying SAA benchmarks relative to the estimated duration of its 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, the Company remains exposed to interest rate risk with respect to the Company's overall net asset position and more generally from an accounting standpoint since the assets are marked to market, while liabilities are accrued at a static rate.

In addition, while the Company's 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 the Company's 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 the Company's 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. The Company has formed several branches with Euro and U.K. sterling functional currencies and continues to focus on attempting to limit exposure to foreign exchange risk.

Foreign currency exchange rate risk in general is reviewed as part of the Company's risk management framework. Within its asset liability framework for the investment portfolio, the Company pursues a general policy of holding the assets and liabilities in the same currency and, as such, the Company is not generally exposed to the risks associated with foreign exchange movements within its 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, realized and unrealized gains and losses are recorded in income in the period in which they occur. These contracts generally have maturities of three months or less. The Company 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 foreign exchange risk for the Company are the U.K. sterling, the Euro, the Swiss franc and the Canadian dollar. The following table provides more information on the Company's net exposures to its principal foreign currencies at June 30, 2012 and December 31, 2011:

| <i>(Foreign Currency in Millions)</i> | June 30, 2012 | December 31, 2011 |
|---------------------------------------|--------------------------|------------------------------|
| Euro | 21.6 | 52.0 |
| U.K. Sterling | 170.6 | 35.1 |
| Swiss Franc | 172.5 | 153.7 |
| Canadian Dollar | 189.1 | 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. The Company is exposed to direct credit risk within its investment portfolio as well as through general counterparties, including customers and reinsurers. The Company manages credit risk within its investment portfolio through its SAA framework and its established investment credit policies, which address quality of obligors and counterparties, industry limits, and diversification requirements. The Company's exposure to market credit spreads primarily relates to market price and cash flow variability associated with changes in credit spreads.

Certain of the Company's underwriting activities expose it to indirect credit risk in that profitability of certain strategies can correlate with credit events at the issuer level, industry level or country level. The Company manages these risks through established underwriting policies which operate in accordance with established limit and escalation frameworks.

The Company has an established credit risk governance process delegated to the Credit Sub-Committee 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 management's risk tolerances.

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 the Company assumes credit exposure, and, if issuer credit spreads increase significantly

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for an extended period of time and in a period of increasing defaults, would also likely result in higher other-than-temporary impairments. 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 the Company's securities if

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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 the Company's consolidated results of operations or financial condition. The credit spread duration in the Company's fixed income portfolio, excluding the impact of the HTM election, was 3.5 years at June 30, 2012.

The Company manages credit risk in the investment portfolio, including fixed income, alternative and short-term investment, through the credit research performed primarily by the investment management service providers. The management of credit risk in the investment portfolio is also fully integrated in the Company's credit risk management governance framework and the management of credit exposures and concentrations within the investment portfolio is carried out in accordance with the Company's risk policies, philosophies, appetites, limits and risk concentrations delegated to the investment portfolio. In the investment portfolio, the Company reviews on a regular basis its asset concentration, credit quality and adherence to the Company's 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 the Company's aggregate fixed income portfolio by credit rating in percentage terms of the Company's aggregate fixed income exposure (including fixed maturities, short-term investments, cash equivalents and net payable for investments purchased) at June 30, 2012.

| | Percentage of Aggregated Fixed Income Portfolio (1)(2) |
|--------------|---|
| AAA | 51.1% |
| AA | 15.9% |
| A | 21.4% |
| BBB | 8.9% |
| BB or Below | 2.6% |
| NR | 0.1% |
| Total | 100.0% |

(1) Included in the above are \$186.1 million or 0.6% of the 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, whether with implicit or explicit government support, reflect the credit quality rating of the U.S. government for the purpose of these calculations.

At June 30, 2012, the average credit quality of the Company's aggregate fixed income investment portfolio was Aa2/AA-. The calculation of average credit quality excludes operating cash. The Company's \$9.1 billion portfolio of government and government related, agency, sovereign and cash holdings were rated AAA at June 30, 2012. The Company's \$11.3 billion portfolio of corporates is rated A-. The Company's \$9.1 billion structured credit portfolio is AA+ rated.

The Company is closely monitoring its corporate financial bond holdings given the events of the past four years. The table below summarizes the Company's 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 its AFS and HTM investment portfolio at June 30, 2012, representing both amortized cost and net unrealized gains (losses):

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June 30, 2012

| <i>(U.S. dollars in millions)</i> Issuer (by Global Ultimate Parent) (1) | Weighted Average Credit Quality (2) | Amortized Cost | Unrealized Gain/ (Loss) |
|---|---|----------------|----------------------------|
| Lloyds Banking Group plc | \$ AA | \$ 144.8 | \$ 3.2 |
| Rabobank Nederland NV | AA | 135.5 | 1.0 |
| National Australia Bank Limited | AA- | 135.3 | (1.6) |
| The Goldman Sachs Group, Inc. | BBB+ | 128.7 | (0.2) |
| Bank of America Corporation | BBB+ | 118.2 | (2.3) |
| JPMorgan Chase & Co. | A- | 114.1 | (4.2) |
| Citigroup Inc. | BBB+ | 105.9 | (0.2) |
| The Bank of Nova Scotia | AA | 101.5 | 3.3 |
| UBS AG | A+ | 97.1 | (0.2) |
| Morgan Stanley | A- | 96.0 | (0.4) |
| Wells Fargo & Company | A+ | 90.0 | 4.3 |
| HSBC Holdings plc | A | 88.7 | (6.1) |
| Westpac Banking Corporation | AA- | 85.3 | 3.5 |
| Credit Suisse Group AG | A+ | 83.8 | 0.8 |
| Canadian Imperial Bank of Commerce | AA | 79.6 | 2.9 |
| Nordea Bank AB | A+ | 75.3 | 0.6 |
| Commonwealth Bank of Australia | AA- | 73.0 | 1.6 |
| Standard Chartered plc | A | 71.6 | 0.2 |
| The Bank of New York Mellon Corporation | AA- | 67.6 | 2.4 |
| Royal Bank of Canada | AA- | 67.6 | 1.7 |
| Bank of Montreal | AA | 61.8 | 2.6 |
| Australia and New Zealand Banking Group Limited | A+ | 60.9 | 0.6 |
| Nationwide Building Society | AA- | 57.0 | (7.2) |
| U.S. Bancorp | A+ | 56.2 | 1.9 |
| BNP Paribas | A+ | 53.8 | 0.1 |
| Government of Netherlands (ABN AMRO) | AAA+ | 51.5 | 5.2 |
| Barclays plc | BBB- | 50.5 | (11.4) |

(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, whether with implicit or explicit government support, reflect the credit quality rating of the U.S. government for the purpose of these calculations.

Within the Company's corporate financial bond holdings, the Company is further monitoring its exposures to hybrid securities, representing Tier One and Upper Tier Two securities of various financial institutions. The following table summarizes the top ten exposures to hybrid securities, listed by amortized cost representing both amortized cost and unrealized (losses):

June 30, 2012

| <i>(U.S. dollars in millions)</i> Issuer (by Global Ultimate Parent) | Tier One Amortized Cost | Upper Tier Two Amortized Cost | Total Amortized Cost | Net Unrealized (Loss) |
|---|----------------------------|----------------------------------|-------------------------|--------------------------|
| Barclays, Plc | \$ 4.7 | \$ 43.0 | \$ 47.7 | \$ (11.5) |
| JPMorgan Chas & Co. | 30.0 | - | 30.0 | (8.5) |
| Zurich Financial Services AG | - | 25.8 | 25.8 | (2.9) |
| Nationwide Building Society | 24.8 | - | 24.8 | (7.2) |
| HSBC Holdings PLC | 22.2 | - | 22.2 | (3.5) |
| Standard Life Plc | - | 21.4 | 21.4 | (4.2) |

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| | | | | |
|--|----------|----------|----------|-----------|
| RSA Insurance Group Plc | - | 20.6 | 20.6 | (2.5) |
| Mitsubishi UFJ Financial Group, Inc. | 20.4 | - | 20.4 | 0.4 |
| The British United Provident Association Limited | - | 20.2 | 20.2 | (4.1) |
| National Australia Bank Limited | 20.1 | - | 20.1 | (3.9) |
| Total | \$ 122.2 | \$ 131.0 | \$ 253.2 | \$ (47.9) |

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At June 30, 2012, the top 10 corporate holdings, which exclude government guaranteed and government sponsored enterprises, represented approximately 3.6% of the aggregate fixed income portfolio and approximately 10.6% 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 Holdings (1) | Percentage of Aggregate Fixed Income Portfolio |
|--------------------------------------|---|
| Lloyds Banking Group PLC | 0.5% |
| Rabobank Nederland NV | 0.4% |
| National Australia Bank Limited | 0.4% |
| The Goldman Sachs Group, Inc. | 0.4% |
| Bank of America Corporation | 0.4% |
| JPMorgan Chase & Co. | 0.3% |
| Citigroup Inc. | 0.3% |
| The Bank of Nova Scotia | 0.3% |
| UBS AG | 0.3% |
| Morgan Stanley | 0.3% |

(1) Corporate issuers include Covered Bonds.

At June 30, 2012, the top 5 corporate sector exposures listed below represented 26.8% of the aggregate fixed income investment portfolio and 79.5% of all corporate holdings.

| (U.S. dollars in millions) Top 5 Sector Exposures | Fair Value | Percentage of Aggregate Fixed Income Portfolio |
|---|-------------------|---|
| Financials (1) | \$ 3,068.4 | 9.3% |
| Consumer, Non-Cyclical | 2,263.5 | 6.9% |
| Utilities | 1,511.4 | 4.6% |
| Communications | 1,000.7 | 3.0% |
| Industrial | 985.9 | 3.0% |
| Total | \$ 8,829.9 | 26.8% |

(1) Government-guaranteed securities and Covered Bonds have been excluded from the above figures.

Within the Company's fixed income portfolios, the Company is further monitoring its exposures to holdings representing risk in certain Euro-zone countries (Greece, Italy, Ireland, Portugal and Spain). In particular, the Company has government holdings of \$13.5 million, corporate holdings of \$162.2 million (financials \$0.3 million, non-financials \$161.9 million) and structured credit holdings totaling \$11.1 million in GIIPS. 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 the Company's 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.

The Company also has exposure to credit risk associated with its mortgage-backed and asset-backed securities. The table below shows the breakdown of the \$9.1 billion structured credit portfolio, of which 79.9% is AAA rated:

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| <i>(U.S. dollars in millions)</i> | Fair Value | Percentage of Structured Portfolio |
|-----------------------------------|-------------------|---|
| Agency RMBS | \$ 5,202.3 | 57.4% |
| Other ABS (1) | 1,625.1 | 17.9% |
| CMBS | 917.3 | 10.1% |
| Non-Agency RMBS | 665.6 | 7.3% |
| Core CDO (non-ABS CDOs and CLOs) | 650.0 | 7.3% |
| Total | \$ 9,060.3 | 100.0% |

(1) Includes Covered Bonds.

Credit Risk Other

Credit derivatives are purchased within the Company's investment portfolio, have been sold through a limited number of contracts written as part of the Company's previous XL financial lines business, and were previously entered into through the Company's prior reinsurance agreements with Syncora. From time to time, the Company 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 the Company's exposure to Credit derivatives, see Item 1, Note 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

The Company has exposure to many different industries and counterparties, and routinely executes 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 the Company to credit risk in the event of default of the Company's counterparty. In addition, with respect to secured transactions, the Company's credit risk may be exacerbated when the collateral held by the Company cannot be sold or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due. The Company also has 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 the Company's business and results of operations.

With regard to unpaid losses and loss expenses recoverable and reinsurance balances receivable, the Company has credit risk should any of its reinsurers be unable or unwilling to settle amounts due to the Company; 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.

The Company is exposed to credit risk in the event of non-performance by the other parties to its derivative instruments in general; however, the Company does not anticipate non-performance. The difference between the notional principal amounts and the associated market value is the Company's maximum credit exposure.

Equity Price Risk

Equity price risk is the potential loss arising from changes in the market value of equities. The Company's equity investment portfolio is exposed to equity price risk. At June 30, 2012, the Company's equity portfolio was approximately \$433.3 million as compared to \$376.6 million at December 31, 2011. This excludes fixed income fund investments of \$95.8 million and \$91.6 million at June 30, 2012 and December 31, 2011, respectively, that generally do not have the risk characteristics of equity investments but are treated as equity investments under GAAP. At June 30, 2012 and December 31, 2011, the Company's direct allocation to equity securities was 1.2% and 1.1%, respectively, of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased.) The Company also estimates the equity risk embedded in certain alternative and private investments. Such estimates are derived from market exposures provided to the Company by certain individual fund investments and/or internal statistical analyses.

Other Market Risks

The Company's 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 June 30, 2012, the Company's exposure to private investments, excluding unfunded commitments, was \$305.7 million, representing 0.9% of the fixed income portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) compared to \$288.4 million at December 31, 2011.

The Company's alternative investment portfolio, which is exposed to equity and credit risk as well as certain other market risks, had a total exposure of \$1,227.4 million representing approximately 3.4% of the investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) at June 30, 2012, as compared to December 31, 2011, when the Company had a total exposure of \$1,027.2 million representing approximately 3.1% of the investment portfolio.

At June 30, 2012, bond and stock index futures outstanding had a net long position of \$25.7 million as compared to a net long position of \$12.6 million at December 31, 2011. The Company may reduce its exposure to these futures through offsetting transactions, including options and forwards.

As noted above, the Company also invests in certain derivative positions that can be impacted by market value movements. For further details on derivative instruments see Item 1, Note 6, Derivative Instruments, to the Unaudited Consolidated Financial Statements included herein.

Sensitivity and Value-at-Risk Analysis

The table below summarizes the Company's assessment of the estimated impact on the value of the Company's investment portfolio at June 30, 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 the Company's investment portfolios at June 30, 2012, excluding foreign exchange.

The interest rate, spread risk, and VaR referenced in the table below include the impact of market movements on the Company's held to maturity fixed maturities from the Company's Life investment portfolios. While the market value of these holdings is sensitive to prevailing interest rates and credit spreads, the Company's book value is not impacted as these holdings are carried at amortized cost. At June 30, 2012, if the Company were to exclude these impacts in order to present the impact of these risks to the Company's book value, the interest rate risk would be reduced by approximately \$307.1 million, absolute spread risk would be reduced by approximately \$208.9 million, relative spread risk would be reduced by approximately \$30.1 million, and VaR would be reduced by approximately \$414.5 million.

The table below excludes the impact of foreign exchange rate risk on the Company's investment portfolio. The Company's investment strategy incorporates asset-liability management, and, accordingly, any foreign exchange movements impact the assets and liabilities equally. See Foreign Currency Exchange Rate Risk, for further details. The Company considers that the investment portfolio VaR estimated results as well as the P&C and Life 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.

| <i>(U.S. dollars in millions)</i> | Interest Rate Risk (1) | Equity Risk (2) | Absolute Spread Risk (3) | Relative Spread Risk (4) | VaR (5), (6) |
|--|---------------------------------------|--------------------------------|---|---|-------------------------|
| Total Investment Portfolio (7) | \$ (1,302.9) | \$ (98.1) | \$ (1,265.7) | \$ (212.8) | \$ 1,006.0 |
| A. P&C Investment Portfolio | \$ (758.1) | \$ (98.1) | \$ (797.6) | \$ (107.9) | \$ 472.5 |
| (I) P&C Fixed Income Portfolio | (758.1) | - | (797.6) | (107.9) | 482.8 |
| (a) Cash & Short Term Investments | (8.4) | - | (2.5) | (0.1) | 16.2 |
| (b) Total Government Related | (283.9) | - | (196.0) | (10.0) | 159.7 |
| (c) Total Corporate Credit | (269.4) | - | (301.2) | (43.7) | 207.2 |
| (d) Total Structured Credit | (196.5) | - | (297.9) | (54.2) | 164.4 |
| (II) P&C Non-Fixed Income Portfolio | - | (98.1) | - | - | 179.8 |
| (e) Equity Portfolio | - | (44.8) | - | - | 99.2 |
| (f) Alternative Portfolio | - | (22.3) | - | - | 79.7 |
| (g) Private Investments | - | (31.1) | - | - | 68.9 |
| (h) Other | - | - | - | - | 3.3 |
| B. Life Investment Portfolio | \$ (537.1) | \$ - | \$ (431.0) | \$ (100.9) | \$ 646.3 |
| (III) Life Fixed Income Portfolio | (537.1) | - | (431.0) | (100.9) | 646.3 |
| (i) Cash & Short Term Investments | (0.1) | - | - | - | 0.2 |
| (j) Total Government Related | (223.6) | - | (85.1) | (6.7) | 307.6 |
| (k) Total Corporate Credit | (255.1) | - | (278.7) | (74.1) | 288.4 |
| (l) Total Structured Credit | (58.3) | - | (67.1) | (20.0) | 72.5 |
| (IV) Life Non-Fixed Income Portfolio | - | - | - | - | - |

- (1) The estimated impact on the fair value of the Company's 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 the Company's investment portfolio of an immediate hypothetical -10% change in the value of equity exposures in the Company's equity portfolio, certain equity-sensitive alternative investments and private equity investments. This includes the Company's estimate of equity risk embedded in the alternatives and private investment portfolio with such estimates utilizing market exposures provided to the Company 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 the Company's fixed income portfolio of an immediate hypothetical +100 basis point increase in all global government related, corporate and structured credit spreads to which the Company's fixed income portfolio is exposed. This excludes exposure to credit spreads in the Company's alternative investments, private investments and counterparty exposure.
- (4) The estimated impact on the fair value of the Company's fixed income portfolio of an immediate hypothetical +10% increase in all global government related, corporate and structured credit spreads to which the Company's fixed income portfolio is exposed. This excludes exposure to credit spreads in the

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Company's 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. The Company's investment portfolio VaR at June 30, 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 the Company's 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 the Company's Total Investment Portfolio, the results also include the impact associated with the Company's Business and Other Investments.
- (7) The Company's Total Investment Portfolio comprises the Company's P&C Investment Portfolio and Life Investment Portfolio as well as the Company's Business and Other Investments that do not form part of the Company's P&C Investment Portfolio or Life Investment Portfolio. The individual results reported in the above table for the Company's Total Investment Portfolio therefore represent the aggregate impact on the Company's P&C Investment Portfolio, Life Investment Portfolio and the majority of the Company's Other Investments.

Stress Testing

VaR does not provide the means to estimate the magnitude of the loss in the 5% of occurrences when the Company expects the VaR level to be exceeded. To complement the VaR analysis based on normal market environments, the Company considers the impact on the investment portfolio in several different stress scenarios to analyze the effect of unusual market conditions. The Company establishes certain stress scenarios which are applied to the actual investment portfolio. As these stress scenarios and estimated gains and losses are based on scenarios established by the Company, 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 the Company's total risk tolerance. It is important to note that when assessing the risk of the Company's investment portfolio, the Company does not take into account either the value or risk associated with the liabilities arising from the Company's operations.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to Rules 13a-15 or 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective to provide reasonable assurance that all material information relating to the Company required to be included in this report has been made known to them in a timely fashion.

Changes in Internal Control Over Financial Reporting

There have been no changes in internal control over financial reporting identified in connection with the Company's evaluation required pursuant to Rules 13a-15 or 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

The Company is subject to legal proceedings and claims, as described in its Annual Report on Form 10-K for the year ended December 31, 2011. Material developments to such proceedings during the three months ended June 30, 2012 are described below.

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 have filed 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 and remains pending against approximately 100 defendants, 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. On October 17, 2011, the District Court lifted the stay of the tag-along actions, including the three in which the XL entities are named defendants. On April 30, 2012, the District Court set a pre-trial litigation schedule governing the tag-along actions.

The Company and its subsidiaries 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 the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company's 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, the Company and its subsidiaries 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. This category of business litigation typically involves, among other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes 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, both individually and in the aggregate, will

not result in losses in amounts exceeding recognized reserves having a material adverse effect on the Company's position or liquidity at June 30, 2012.

ITEM 1A. RISK FACTORS

Refer to Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for further information.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) Purchases of Equity Securities by the Issuer and Affiliate Purchasers

The following table provides information about purchases by the Company during the three months ended June 30, 2012 of equity securities that are registered by the Company 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 Purchased Under the Plans or Programs (1) (2) |
|---------------------------------|---|------------------------------------|---|---|
| April 1, 2012 to April 30, 2012 | 2,053 | \$ 21.69 | - | \$ 650.0 million |
| May 1, 2012 to May 31, 2012 | 3,007,103 | 20.83 | 2,994,077 | 587.7 million |
| June 1, 2012 to June 30, 2012 | 3,121,693 | 20.08 | 3,120,076 | 525.0 million |
| Total | 6,130,849 | \$ 20.45 | 6,114,153 | \$ 525.0 million |

- (1) Shares purchased in connection with the vesting of restricted shares granted under the Company's 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 the Company's share buyback programs noted below.
- (2) On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to \$750 million of its 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 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares under the new program for \$100.0 million and \$125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company's constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, \$525.0 million remained available for purchase under the new program.

ITEM 6. EXHIBITS

The following exhibits are filed as exhibits to this Quarterly Report:

- 10.1 XL Group plc Reinsurance Supplemental Long Term Cash Incentive Compensation Plan, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (No. 1-10804) filed on April 30, 2012
- 10.2* X.L. America, Inc. Deferred Compensation Plan
- 10.3* 2012 Form of Letter Agreement between XL Global Services, Inc. and/or XL Group plc and certain executive officers
- 12* Statements regarding computation of ratios
- 31* Rule 13a-14(a)/15d-14(a) Certifications
- 32* Section 1350 Certification
- 101.INS* XBRL Instance Document**
- 101.SCH* XBRL Taxonomy Extension Schema Document**
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase Document**
- 101.LAB* XBRL Taxonomy Extension Label Linkbase Document**
- 101.PRE* XBRL Taxonomy Extension Presentation Linkbase Document**
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase Document**

* Filed herewith.

** These interactive data files are furnished and deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended and otherwise are not subject to liability under those sections.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 8, 2012

XL Group plc
(Registrant)
/s/ MICHAEL S. MCGAVICK

Name: Michael S. McGavick
Title: Chief Executive Officer and Director
XL Group plc

Date: August 8, 2012

/s/ PETER R. PORRINO

Name: Peter R. Porrino
Title: Executive Vice President and Chief Financial Officer
XL Group plc