

XL GROUP PLC  
Form 10-Q  
August 08, 2012

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**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, 4<sup>th</sup> 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.

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**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>	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<b>ASSETS</b>		
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
<b>Total assets</b>	<b>\$ 44,940,156</b>	<b>\$ 44,665,265</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
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
<b>Total liabilities</b>	<b>\$ 33,726,354</b>	<b>\$ 33,909,135</b>
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
<b>Total shareholders' equity</b>	<b>\$ 11,213,802</b>	<b>\$ 10,756,130</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 44,940,156</b>	<b>\$ 44,665,265</b>

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>				
<b>Revenues:</b>				
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
<b>Total revenues</b>	\$ 1,746,739	\$ 1,695,182	\$ 3,499,171	\$ 3,310,040
<b>Expenses:</b>				
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
<b>Total expenses</b>	\$ 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)
<b>Net income (loss)</b>	\$ 224,610	\$ 227,765	\$ 437,795	\$ 33,817
Non-controlling interests	(3,454)	(2,102)	(40,011)	(35,438)
<b>Net income (loss) attributable to XL Group plc and ordinary shareholders</b>	\$ 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>				
<b>Net income (loss) attributable to XL Group plc</b>	\$ 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
<b>Comprehensive income (loss)</b>	\$ 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
<b>Ordinary Shares:</b>		
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	-
<b>Balance - end of period</b>	<b>\$ 3,057</b>	<b>\$ 3,052</b>
<b>Additional Paid in Capital:</b>		
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
<b>Balance - end of period</b>	<b>\$ 8,738,204</b>	<b>\$ 8,756,300</b>
<b>Accumulated Other Comprehensive Income (Loss):</b>		
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
<b>Balance - end of period</b>	<b>\$ 910,760</b>	<b>\$ 422,971</b>
<b>Retained Earnings (Deficit):</b>		
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)
<b>Balance - end of period</b>	<b>\$ 215,788</b>	<b>\$ 430,347</b>
<b>Non-controlling Interest in Equity of Consolidated Subsidiaries:</b>		
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)
<b>Balance - end of period</b>	<b>\$ 1,345,993</b>	<b>\$ 1,001,781</b>
<b>Total Shareholders Equity</b>	<b>\$ 11,213,802</b>	<b>\$ 10,614,451</b>

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
<b>Cash flows provided by (used in) operating activities:</b>		
Net income (loss)	\$ 437,795	\$ 33,817
<b>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:</b>		
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
<b>Total adjustments</b>	<b>\$ 45,801</b>	<b>\$ 73,510</b>
<b>Net cash provided by (used in) operating activities</b>	<b>\$ 483,596</b>	<b>\$ 107,327</b>
<b>Cash flows provided by (used in) investing activities:</b>		
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
<b>Net cash provided by (used in) investing activities</b>	<b>\$ (5,523)</b>	<b>\$ 84,364</b>
<b>Cash flows provided by (used in) financing activities:</b>		
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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<b>Net cash provided by (used in) financing activities</b>	\$	(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)
<b>Cash and cash equivalents - beginning of period</b>		3,825,125		3,022,868
<b>Cash and cash equivalents - end of period</b>	\$	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.

**XL GROUP PLC**

**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
<b>Assets</b>					
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
<b>Liabilities</b>					

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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
<b>Assets</b>					
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
<b>Liabilities</b>					
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
<b>Financial Assets</b>	<b>\$ 3,030,372</b>	<b>\$ 3,296,866</b>	<b>\$ 2,992,683</b>	<b>\$ 3,192,792</b>
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
<b>Financial Liabilities</b>	<b>\$ 3,274,516</b>	<b>\$ 3,696,935</b>	<b>\$ 3,883,435</b>	<b>\$ 4,149,960</b>

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&amp;C and Life Operations

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

## Corporate &amp; 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&amp;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)
<b>Contribution from P&amp;C and Life Operations</b>			\$ 254,543	\$ 25,164	\$ 279,707
<b>Corporate &amp; other:</b>					
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)
<b>Net income (loss) attributable to XL Group plc</b>					\$ 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&amp;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
<b>Contribution from P&amp;C and Life Operations</b>			\$ 547,881	\$ 26,027	\$ 573,908
<b>Corporate &amp; other:</b>					
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)
<b>Net income (loss) attributable to XL Group plc</b>					\$ 397,784

## Ratios P&amp;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&amp;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&amp;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)
<b>Contribution from P&amp;C and Life Operations</b>			\$ 86,114	\$ 9,600	\$ 95,714
<b>Corporate &amp; other:</b>					
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
<b>Net income (loss) attributable to XL Group plc</b>					\$ (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&amp;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
<b>P&amp;C Operations:</b>				
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
<b>Total P&amp;C Operations</b>	<b>\$ 959,294</b>	<b>\$ 441,678</b>	<b>\$ -</b>	<b>\$ 1,400,972</b>
<b>Life Operations:</b>				
Annuity	\$ -	\$ -	\$ 31,243	\$ 31,243
Other Life	-	-	54,380	54,380
<b>Total Life Operations</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 85,623</b>	<b>\$ 85,623</b>
<b>Total</b>	<b>\$ 959,294</b>	<b>\$ 441,678</b>	<b>\$ 85,623</b>	<b>\$ 1,486,595</b>

## Three Months Ended June 30, 2011

(U.S. dollars in thousands)

	Insurance	Reinsurance	Life Operations	Total
<b>P&amp;C Operations:</b>				
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
<b>Total P&amp;C Operations</b>	<b>\$ 907,443</b>	<b>\$ 398,682</b>	<b>\$ -</b>	<b>\$ 1,306,125</b>
<b>Life Operations:</b>				
Annuity	\$ -	\$ -	\$ 33,968	\$ 33,968
Other Life	-	-	58,246	58,246
<b>Total Life Operations</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 92,214</b>	<b>\$ 92,214</b>
<b>Total</b>	<b>\$ 907,443</b>	<b>\$ 398,682</b>	<b>\$ 92,214</b>	<b>\$ 1,398,339</b>

(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.

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

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## 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
<b>P&amp;C Operations:</b>				
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
<b>Total P&amp;C Operations</b>	<b>\$ 1,893,350</b>	<b>\$ 865,520</b>	<b>\$ -</b>	<b>\$ 2,758,870</b>
<b>Life Operations:</b>				
Annuity	\$ -	\$ -	\$ 62,700	\$ 62,700
Other Life	-	-	101,443	101,443
<b>Total P&amp;C Operations</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 164,143</b>	<b>\$ 164,143</b>
<b>Total</b>	<b>\$ 1,893,350</b>	<b>\$ 865,520</b>	<b>\$ 164,143</b>	<b>\$ 2,923,013</b>

## Six Months Ended June 30, 2011

(U.S. dollars in thousands)

	Insurance	Reinsurance	Life Operations	Total
<b>P&amp;C Operations:</b>				
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
<b>Total P&amp;C Operations</b>	<b>\$ 1,783,363</b>	<b>\$ 794,458</b>	<b>\$ -</b>	<b>\$ 2,577,821</b>
<b>Life Operations:</b>				
Annuity	\$ -	\$ -	\$ 66,891	\$ 66,891
Other Life	-	-	115,010	115,010
<b>Total P&amp;C Operations</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 181,901</b>	<b>\$ 181,901</b>
<b>Total</b>	<b>\$ 1,783,363</b>	<b>\$ 794,458</b>	<b>\$ 181,901</b>	<b>\$ 2,759,722</b>

(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	
<b>Fixed maturities - AFS</b>					
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
<b>Total fixed maturities - AFS</b>	<b>\$ 25,442,779</b>	<b>\$ 1,348,756</b>	<b>\$ (401,150)</b>	<b>\$ (147,583)</b>	<b>\$ 26,242,802</b>
<b>Total short-term investments (1)</b>	<b>\$ 227,321</b>	<b>\$ 293</b>	<b>\$ (234)</b>	<b>\$ -</b>	<b>\$ 227,380</b>
<b>Total equity securities</b>	<b>\$ 553,715</b>	<b>\$ 3,212</b>	<b>\$ (27,871)</b>	<b>\$ -</b>	<b>\$ 529,056</b>
<b>Total investments - AFS</b>	<b>\$ 26,223,815</b>	<b>\$ 1,352,261</b>	<b>\$ (429,255)</b>	<b>\$ (147,583)</b>	<b>\$ 26,999,238</b>
<b>Fixed maturities - HTM</b>					
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
<b>Total investments - HTM</b>	<b>\$ 2,716,357</b>	<b>\$ 303,135</b>	<b>\$ (12,500)</b>	<b>\$ -</b>	<b>\$ 3,006,992</b>

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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	Related to Changes in Estimated Fair Value	Non-credit Related OTTI	Fair Value
<b>Gross Unrealized Losses</b>					
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
<b>Total fixed maturities - AFS</b>	<b>\$ 25,771,715</b>	<b>\$ 1,194,038</b>	<b>\$ (589,070)</b>	<b>\$ (186,658)</b>	<b>\$ 26,190,025</b>
<b>Total short-term investments (1)</b>	<b>\$ 359,378</b>	<b>\$ 519</b>	<b>\$ (834)</b>	<b>\$ -</b>	<b>\$ 359,063</b>
<b>Total equity securities</b>	<b>\$ 480,685</b>	<b>\$ 27,947</b>	<b>\$ (40,435)</b>	<b>\$ -</b>	<b>\$ 468,197</b>
<b>Total investments - AFS</b>	<b>\$ 26,611,778</b>	<b>\$ 1,222,504</b>	<b>\$ (630,339)</b>	<b>\$ (186,658)</b>	<b>\$ 27,017,285</b>
<b>Fixed maturities - HTM</b>					
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
<b>Total investments - HTM</b>	<b>\$ 2,668,978</b>	<b>\$ 247,445</b>	<b>\$ (20,735)</b>	<b>\$ -</b>	<b>\$ 2,895,688</b>

- (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>				
<b>Fixed maturities - AFS</b>				
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
<b>Total fixed maturities - AFS</b>	\$ 25,442,779	\$ 26,242,802	\$ 25,771,715	\$ 26,190,025
<b>Fixed maturities - HTM</b>				
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
<b>Total fixed maturities - HTM</b>	\$ 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.

## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 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
<b>June 30, 2012</b>				
<i>(U.S. dollars in thousands)</i>				
<b>Fixed maturities and short-term investments - AFS</b>				
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)
<b>Total fixed maturities and short-term investments - AFS</b>	<b>\$ 1,295,169</b>	<b>\$ (26,298)</b>	<b>\$ 2,368,776</b>	<b>\$ (522,669)</b>
<b>Total equity securities (4)</b>	<b>\$ 422,204</b>	<b>\$ (27,871)</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Fixed maturities -HTM</b>				
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)
<b>Total fixed maturities - HTM</b>	<b>\$ 57,559</b>	<b>\$ (924)</b>	<b>\$ 58,342</b>	<b>\$ (11,576)</b>

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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.

## XL GROUP PLC

## 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
<b>Fixed maturities and short-term investments - AFS</b>				
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)
<b>Total fixed maturities and short-term investments - AFS</b>	<b>\$ 2,375,175</b>	<b>\$ (88,253)</b>	<b>\$ 2,782,909</b>	<b>\$ (688,309)</b>
<b>Total equity securities (4)</b>	<b>\$ 361,585</b>	<b>\$ (40,435)</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Fixed maturities -HTM</b>				
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)
<b>Total fixed maturities - HTM</b>	<b>\$ 244,193</b>	<b>\$ (9,322)</b>	<b>\$ 81,779</b>	<b>\$ (11,413)</b>

- (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.



## XL GROUP PLC

## 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
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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.

## XL GROUP PLC

## 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.

**XL GROUP PLC**

**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**