

XL GROUP PLC
Form 10-Q
May 07, 2013

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 March 31, 2013

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)

No. 1 Hatch Street Upper, 4th Floor, Dublin 2, Ireland

(Address of principal executive offices and zip code)

+353 (1) 405-2033

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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 May 3, 2013, there were 289,702,885 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
 XL GROUP PLC
 UNAUDITED CONSOLIDATED BALANCE SHEETS

(U.S. dollars in thousands, except share data)	March 31, 2013	December 31, 2012
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost: 2013: \$26,188,523; 2012: \$26,544,806)	\$27,349,185	\$27,846,920
Equity securities, at fair value (cost: 2013: \$790,132; 2012: \$617,486)	850,970	649,359
Short-term investments, at fair value (amortized cost: 2013: \$260,021; 2012: \$322,563)	258,269	322,703
Total investments available for sale	\$28,458,424	\$28,818,982
Fixed maturities, held to maturity at amortized cost (fair value: 2013: \$3,086,378; 2012: \$3,262,804)	2,661,821	2,814,447
Investments in affiliates	1,225,840	1,126,875
Other investments	1,142,188	1,219,879
Total investments	\$33,488,273	\$33,980,183
Cash and cash equivalents	2,473,287	2,618,378
Accrued investment income	316,718	342,778
Deferred acquisition costs	732,218	675,705
Ceded unearned premiums	646,269	587,909
Premiums receivable	3,156,137	2,568,861
Reinsurance balances receivable	99,337	58,428
Unpaid losses and loss expenses recoverable	3,341,855	3,382,101
Receivable from investments sold	39,659	16,002
Goodwill and other intangible assets	406,748	408,527
Deferred tax asset	172,446	166,142
Other assets	649,316	582,765
Total assets	\$45,522,263	\$45,387,779
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Unpaid losses and loss expenses	\$20,177,581	\$20,484,121
Deposit liabilities	1,527,323	1,551,398
Future policy benefit reserves	4,550,916	4,812,045
Unearned premiums	4,342,664	3,755,920
Notes payable and debt	1,672,206	1,672,778
Reinsurance balances payable	267,472	143,112
Payable for investments purchased	145,854	102,112
Deferred tax liability	110,984	141,803
Other liabilities	895,417	868,093
Total liabilities	\$33,690,417	\$33,531,382
Commitments and Contingencies		
Shareholders' Equity:		
Ordinary shares, 999,990,000 authorized, par value \$0.01; issued and outstanding: (2013: 291,831,433; 2012: 298,681,573)	\$2,918	\$2,987

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Additional paid in capital	8,371,527	8,584,753
Accumulated other comprehensive income	1,405,110	1,520,011
Retained earnings (deficit)	707,791	402,321
Shareholders' equity attributable to XL Group plc	\$10,487,346	\$10,510,072
Non-controlling interest in equity of consolidated subsidiaries	1,344,500	1,346,325
Total shareholders' equity	\$11,831,846	\$11,856,397
Total liabilities and shareholders' equity	\$45,522,263	\$45,387,779
See accompanying Notes to Unaudited Consolidated Financial Statements		

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XL GROUP PLC
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended March 31,	
	2013	2012
(U.S. dollars in thousands, except per share data)		
Revenues:		
Net premiums earned	\$ 1,529,691	\$ 1,436,418
Net investment income	246,469	265,242
Realized investment gains (losses):		
Net realized gains (losses) on investments sold	41,147	41,768
Other-than-temporary impairments on investments	(3,727	) (18,565
Other-than-temporary impairments on investments transferred to (from) other comprehensive income	(910	) (2,400
Total net realized gains (losses) on investments	\$36,510	\$20,803
Net realized and unrealized gains (losses) on derivative instruments	7,885	702
Income (loss) from investment fund affiliates	32,221	19,408
Fee income and other	9,632	9,859
Total revenues	\$ 1,862,408	\$ 1,752,432
Expenses:		
Net losses and loss expenses incurred	\$843,084	\$854,065
Claims and policy benefits	110,954	121,307
Acquisition costs	220,259	224,151
Operating expenses	283,833	282,411
Exchange (gains) losses	(33,435	) 12,718
Interest expense	38,700	39,298
Total expenses	\$ 1,463,395	\$ 1,533,950
Income (loss) before income tax and income (loss) from operating affiliates	\$399,013	\$218,482
Income (loss) from operating affiliates	30,998	16,253
Provision (benefit) for income tax	43,479	21,550
Net income (loss)	\$386,532	\$213,185
Non-controlling interests	(35,742	) (36,557
Net income (loss) attributable to XL Group plc and ordinary shareholders	\$350,790	\$176,628
Weighted average ordinary shares and ordinary share equivalents outstanding – basic	295,000	315,120
Weighted average ordinary shares and ordinary share equivalents outstanding – diluted	299,469	317,639
Earnings (loss) per ordinary share and ordinary share equivalent – basic	\$ 1.19	\$0.56
Earnings (loss) per ordinary share and ordinary share equivalent –diluted	\$ 1.17	\$0.56
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended	
	March 31,	
(U.S. dollars in thousands)	2013	2012
Net income (loss) attributable to XL Group plc	\$350,790	\$176,628
Change in net unrealized gains (losses) on investments, net of tax	(112,222)	212,324
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	(4,435)	15,050
Change in OTTI losses recognized in other comprehensive income, net of tax	5,182	12,421
Change in underfunded pension liability	385	(174)
Change in value of cash flow hedge	110	110
Foreign currency translation adjustments	(3,921)	8,721
Comprehensive income (loss)	\$235,889	\$425,080
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC
UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(U.S. dollars in thousands)	Three Months Ended March 31,	
	2013	2012
Ordinary Shares:		
Balance - beginning of year	\$2,987	\$3,156
Issuance of ordinary shares	8	8
Buybacks of ordinary shares	(80	) (48
Exercise of stock options	3	1
Balance - end of period	\$2,918	\$3,117
Additional Paid in Capital:		
Balance - beginning of year	\$8,584,753	\$8,938,679
Issuance of ordinary shares	7	7
Buybacks of ordinary shares	(220,572	) (100,442
Exercise of stock options	4,313	942
Share-based compensation expense	3,026	7,646
Balance - end of period	\$8,371,527	\$8,846,832
Accumulated Other Comprehensive Income (Loss):		
Balance - beginning of year	\$1,520,011	\$583,064
Change in net unrealized gains (losses) on investments, net of tax	(112,222	) 212,324
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	(4,435	) 15,050
Change in OTTI losses recognized in other comprehensive income, net of tax	5,182	12,421
Change in underfunded pension liability	385	(174
Change in value of cash flow hedge	110	110
Foreign currency translation adjustments	(3,921	) 8,721
Balance - end of period	\$1,405,110	\$831,516
Retained Earnings (Deficit):		
Balance - beginning of year	\$402,321	\$(113,241
Net income (loss) attributable to XL Group plc	350,790	176,628
Dividends on ordinary shares	(41,553	) (34,830
Buybacks of ordinary shares	(3,767) —
Balance - end of period	\$707,791	\$28,557
Non-controlling Interest in Equity of Consolidated Subsidiaries:		
Balance - beginning of year	\$1,346,325	\$1,344,472
Non-controlling interests - distribution	(37) —
Non-controlling interests	82	—
Non-controlling interest share in change in accumulated other comprehensive income (loss)	(29	) (5
Non-controlling interests - deconsolidation	(1,841) —
Balance - end of period	\$1,344,500	\$1,344,467
Total Shareholders' Equity	\$11,831,846	\$11,054,489
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31,	
(U.S. dollars in thousands)	2013	2012
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$386,532	\$213,185
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Net realized (gains) losses on investments	(36,510)	(20,803)
Net realized and unrealized (gains) losses on derivative instruments	(7,885)	(702)
Amortization of premiums (discounts) on fixed maturities	37,783	36,678
(Income) loss from investment and operating affiliates	(63,219)	(35,661)
Share-based compensation	15,086	11,172
Depreciation	13,109	13,859
Accretion of deposit liabilities	12,564	16,446
Changes in:		
Unpaid losses and loss expenses	(117,861)	(444,959)
Future policy benefit reserves	(48,114)	(37,565)
Unearned premiums	636,875	655,416
Premiums receivable	(629,528)	(573,122)
Unpaid losses and loss expenses recoverable	2,973	245,960
Ceded unearned premiums	(65,191)	(47,201)
Reinsurance balances receivable	(41,234)	(38,319)
Deferred acquisition costs	(70,547)	(81,792)
Reinsurance balances payable	129,253	243,696
Deferred tax asset - net	(17,565)	9,243
Derivatives	52,675	(17,908)
Other assets	(24,197)	42,434
Other liabilities	(23,052)	(45,522)
Other	3,697	8,835
Total adjustments	\$(240,888)	\$(59,815)
Net cash provided by (used in) operating activities	\$145,644	\$153,370
Cash flows provided by (used in) investing activities:		
Proceeds from sale of fixed maturities and short-term investments	\$1,198,391	\$1,499,832
Proceeds from redemption of fixed maturities and short-term investments	1,174,101	1,246,431
Proceeds from sale of equity securities	37,446	7,635
Purchases of fixed maturities and short-term investments	(2,262,022)	(3,385,981)
Purchases of equity securities	(209,793)	(119,052)
Net dispositions of investment affiliates	(62,387)	34,358
Other investments, net	121,771	(45,333)
Net cash provided by (used in) investing activities	\$(2,493)	\$(762,110)
Cash flows provided by (used in) financing activities:		
Proceeds from issuance of ordinary shares and exercise of stock options	\$3,248	\$942
Buybacks of ordinary shares	(224,420)	(100,490)
Dividends paid on ordinary shares	(805)	(1,218)
Distributions to non-controlling interests	(3,257)	(3,985)
Repayment of debt	—	(600,000)
Deposit liabilities	(38,704)	(30,437)
Net cash provided by (used in) financing activities	\$(263,938)	\$(735,188)

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Effects of exchange rate changes on foreign currency cash	(24,304) 25,121
Increase (decrease) in cash and cash equivalents	\$(145,091) \$(1,318,807)
Cash and cash equivalents - beginning of period	2,618,378	3,825,125
Cash and cash equivalents - end of period	\$2,473,287	\$2,506,318
See accompanying Notes to Unaudited Consolidated Financial Statements		

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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 was 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. For further information, see Item 8, Note 2(a), “Significant Accounting Policies – Basis of Preparation and Consolidation,” to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012. 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 June 2011, the FASB issued an accounting standards update concerning the presentation of comprehensive income in financial statements. This guidance allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income only as part of the statement of changes in shareholders' equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company adopted the guidance from January 1, 2012; however, it did not have an impact on the Company's disclosure, financial condition or results of operations or cash flows. In February 2013, the FASB issued an additional accounting standards update related to this topic that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The guidance was adopted prospectively from January 1, 2013. As this guidance is disclosure-related only and does not change the current requirements for reporting net income or other comprehensive income in financial statements, its adoption did not impact the Company's financial condition, results of operations, or cash flows.

In December 2011, the FASB issued an accounting standards update requiring additional disclosures about financial instruments and derivatives that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. In January 2013, the FASB issued an additional accounting standards update related to this topic clarifying that the disclosures would apply only to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions, each to the extent that they met one of the two conditions provided in the initial accounting standards update. This guidance was adopted from January 1, 2013, on a retrospective basis for all fiscal periods presented. As this guidance is disclosure-related only and does not amend existing balance sheet offsetting guidance, its adoption did not impact the Company's financial condition, results of

operations, or cash flows.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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.

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, 2012.

XL GROUP PLC
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(a) Fair Value Summary

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at March 31, 2013 and December 31, 2012 by level within the fair value hierarchy:

March 31, 2013 (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 March 31, 2013
Assets					
U.S. Government and Government - Related/Supported	\$—	\$1,978,000	\$—	\$—	\$1,978,000
Corporate (1) (2)	—	10,264,509	40,815	—	10,305,324
Residential mortgage-backed securities – Agency (“RMBS - Agency”)	—	4,821,601	19,107	—	4,840,708
Residential mortgage-backed securities – Non-Agency (“RMBS - Non-Agency”)	—	593,288	103	—	593,391
Commercial mortgage-backed securities (“CMBS”)	—	1,128,329	25,012	—	1,153,341
Collateralized debt obligations (“CDO”)	—	8,163	702,904	—	711,067
Other asset-backed securities (2)	—	1,244,792	35,887	—	1,280,679
U.S. States and political subdivisions of the States	—	1,889,269	—	—	1,889,269
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	—	4,597,406	—	—	4,597,406
Total fixed maturities, at fair value	\$—	\$26,525,357	\$823,828	\$—	\$27,349,185
Equity securities, at fair value (3)	369,864	481,106	—	—	850,970
Short-term investments, at fair value (1)(4)	—	256,252	2,017	—	258,269
Total investments available for sale	\$369,864	\$27,262,715	\$825,845	\$—	\$28,458,424
Cash equivalents (5)	1,347,072	343,554	—	—	1,690,626
Other investments (6)	—	717,214	113,322	—	830,536
Other assets (7)	—	108,745	—	(680)	108,065
Total assets accounted for at fair value	\$1,716,936	\$28,432,228	\$939,167	\$(680)	\$31,087,651
Liabilities					
Financial instruments sold, but not yet purchased (8)	\$165	\$30,105	\$—	\$—	\$30,270
Other liabilities (7)	—	28,844	32,550	(680)	60,714
Total liabilities accounted for at fair value	\$165	\$58,949	\$32,550	\$(680)	\$90,984

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

December 31, 2012 (U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at December 31, 2012
Assets					
U.S. Government and Government - Related/Supported	\$—	\$2,034,617	\$—	\$—	\$2,034,617
Corporate (1) (2)	—	10,451,902	30,098	—	10,482,000
RMBS – Agency	—	5,223,488	32,005	—	5,255,493
RMBS – Non-Agency	—	647,617	116	—	647,733
CMBS	—	1,051,904	25,347	—	1,077,251
CDO	—	8,080	701,736	—	709,816
Other asset-backed securities (2)	—	1,452,583	18,128	—	1,470,711
U.S. States and political subdivisions of the States	—	1,911,017	—	—	1,911,017
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	—	4,258,282	—	—	4,258,282
Total fixed maturities, at fair value	\$—	\$27,039,490	\$807,430	\$—	\$27,846,920
Equity securities, at fair value (3)	253,957	395,402	—	—	649,359
Short-term investments, at fair value (1)(4)	—	322,703	—	—	322,703
Total investments available for sale	\$253,957	\$27,757,595	\$807,430	\$—	\$28,818,982
Cash equivalents (5)	1,596,376	408,292	—	—	2,004,668
Other investments (6)	—	792,483	115,272	—	907,755
Other assets (7)	—	24,842	—	(1,327)	23,515
Total assets accounted for at fair value	\$1,850,333	\$28,983,212	\$922,702	\$(1,327)	\$31,754,920
Liabilities					
Financial instruments sold, but not yet purchased (8)	\$—	\$26,235	\$—	\$—	\$26,235
Other liabilities (7)	—	30,379	36,247	(1,327)	65,299
Total liabilities accounted for at fair value	\$—	\$56,614	\$36,247	\$(1,327)	\$91,534

Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes had a fair value of \$193.7 million and \$194.3 million and (1) an amortized cost of \$192.4 million and \$194.8 million at March 31, 2013 and December 31, 2012, 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.

The Company invests in covered bonds (“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 (2) March 31, 2013 and December 31, 2012, Covered Bonds with a fair value of \$521.0 million and \$647.1 million, respectively, are included within Other asset-backed securities.

(3)

Included within Equity securities are investments in fixed income funds with a fair value of \$101.0 million and \$101.9 million at March 31, 2013 and December 31, 2012, respectively.

- (4) Short-term investments consist primarily of Corporate securities and U.S. and Non-U.S. Government and Government-Related/ Supported securities.
- (5) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to fair value measurement guidance.
The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments, which totaled \$311.7 million at March 31, 2013 and \$312.1 million at December 31, 2012, are carried at amortized cost. For further information, see Item 8, Note 7, "Other Investments," to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2012.
- (6) 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 fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy. For further details regarding derivative fair values and associated collateral received or paid see Note 6, "Derivative Instruments," to the Unaudited Consolidated Financial Statements.
- (7) Financial instruments sold, but not yet purchased, represent "short sales" and are included within "Payable for investments purchased" on the balance sheet.
- (8)

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(b) Level 3 Assets and Liabilities

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables present a reconciliation of the beginning and ending balances for the three months ended March 31, 2013 and 2012 for all financial assets and liabilities measured at fair value using significant unobservable inputs (Level 3) at March 31, 2013 and 2012, 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 March 31, 2013 and 2012. 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 those provided by independent pricing services that do not contain significant unobservable inputs and other valuations sourced from brokers that are considered Level 3.

There were no significant transfers between Level 1 and Level 2 during the three months ended March 31, 2013 and 2012.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(U.S. dollars in thousands)	Level 3 Assets and Liabilities -Three Months Ended March 31, 2013				
	Corporate	RMBS - Agency	RMBS - Non Agency	CMBS	CDO
Balance, beginning of period	\$30,098	\$ 32,005	\$116	\$25,347	\$701,736
Realized gains (losses)	(2	) 13	—	—	356
Movement in unrealized gains (losses)	204	(18	) —	1	21,255
Purchases and issuances	10,621	—	—	—	—
Sales	—	(535) —	—	—
Settlements	(106	) (893	) (13	) (336	) (20,443
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	(11,465) —	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—
Balance, end of period	\$40,815	\$ 19,107	\$103	\$25,012	\$702,904
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$202	\$ (5	) \$—	\$1	\$20,892

(U.S. dollars in thousands)	Level 3 Assets and Liabilities -Three Months Ended March 31, 2013				
	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	\$18,128	\$ —	\$—	\$115,272	\$(36,247
Realized gains (losses)	51	—	—	2,915	—
Movement in unrealized gains (losses)	1,475	—	—	(1,902	) 3,697
Purchases and issuances	21,686	—	2,017	1,905	—
Sales	—	—	—	—	—
Settlements	(5,453	) —	—	(4,868) —
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—
Balance, end of period	\$35,887	\$ —	\$2,017	\$113,322	\$(32,550
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$7	\$ —	\$—	\$1,013	\$3,697

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(U.S. dollars in thousands)	Level 3 Assets and Liabilities - Three Months Ended March 31, 2012				
	Corporate	RMBS - Agency	RMBS - Non Agency	CMBS	CDO
Balance, beginning of period	\$23,818	\$ 32,041	\$—	\$—	\$650,851
Realized gains (losses)	(18	) 13	—	—	(1,649)
Movement in unrealized gains (losses)	(315	) (79)	—	—	33,116
Purchases and issuances	9,076	36	—	—	—
Sales	—	(1,334	) —	—	(37,181)
Settlements	(137	) (1,014	) —	—	(6,440)
Transfers into Level 3	881	10,132	—	—	—
Transfers out of Level 3	—	—	—	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—
Balance, end of period	\$33,305	\$ 39,795	\$—	\$—	\$638,697
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$(332	) \$ (54	) \$—	\$—	\$29,202

(U.S. dollars in thousands)	Level 3 Assets and Liabilities - Three Months Ended March 31, 2012				
	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)	21	—	—	1,925	—
Movement in unrealized gains (losses)	(163	) —	—	899	2,014
Purchases and issuances	—	—	—	1,317	—
Sales	—	—	—	—	—
Settlements	—	—	—	(2,441) —
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—
Balance, end of period	\$ 16,410	\$ —	\$—	\$115,659	\$(40,630)
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$(431	) \$ —	\$—	\$(313	) \$2,014

(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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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 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, 2012.

(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.

(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 March 31, 2013 and December 31, 2012. 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, and are subject to the same control environment previously described.

(U.S. dollars in thousands)	March 31, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturities, held to maturity	\$2,661,821	\$3,086,378	\$2,814,447	\$3,262,804
Other investments - structured transactions	311,651	304,439	312,122	293,813
Financial Assets	\$2,973,472	\$3,390,817	\$3,126,569	\$3,556,617

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Deposit liabilities	\$1,527,323	\$1,855,009	\$1,551,398	\$1,878,499
Notes payable and debt	1,672,206	1,908,871	1,672,778	1,918,134
Financial Liabilities	\$3,199,529	\$3,763,880	\$3,224,176	\$3,796,633

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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 71.9 basis points at March 31, 2013 and the appropriate U.S. Treasury rate plus 100.3 basis points at December 31, 2012. 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.

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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 segment 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 March 31, 2013 (U.S. dollars in thousands, except ratios)	Insurance	Reinsurance	Total P&C	Life Operations	Total
Gross premiums written	\$1,497,787	\$907,129	\$2,404,916	\$72,970	\$2,477,886
Net premiums written	1,189,188	853,021	2,042,209	65,445	2,107,654
Net premiums earned	1,039,092	425,154	1,464,246	65,445	1,529,691
Net losses and loss expenses	650,517	192,567	843,084	110,954	954,038
Acquisition costs	130,622	85,534	216,156	4,103	220,259
Operating expenses (1)	183,997	40,421	224,418	2,595	227,013
Underwriting profit (loss)	\$73,956	\$106,632	\$180,588	\$(52,207)	\$128,381
Net investment income			157,040	71,688	228,728
Net results from structured products (2)	4,185	991	5,176	—	5,176
Net fee income and other (3)	(1,939)	) 632	(1,307)	) 1,043	(264)
Net realized gains (losses) on investments			45,579	(9,069)	) 36,510
Contribution from P&C and Life Operations			\$387,076	\$11,455	\$398,531
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					7,885
Net income (loss) from investment fund affiliates and operating affiliates (4)					63,219
Exchange gains (losses)					33,435
Corporate operating expenses					46,923
Interest expense (5)					26,136
Non-controlling interests					35,742
Income tax expense					