XL CAPITAL LTD
Form 10-K
March 01, 2010

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

FORM 10-K

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009
OR

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from - to -
Commission file number 1-10804

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

Cayman Islands (State or other jurisdiction of incorporation or organization)	98-0191089 (I.R.S. Employer Identification No.)
XL House, One Bermudiana Road Hamilton, Bermuda HM 08 (Address of principal executive offices and zip code)	(441) 292-8515 (Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Class A Ordinary Shares, Par Value $0.01 per Share	New York Stock Exchange
10.75% Equity Security Units	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes S No £

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. £

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

Large accelerated filer S Accelerated filer £ Non-accelerated filer £ Smaller reporting company £

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

The aggregate market value of the voting common equity of the registrant held by non-affiliates of the registrant on June 30, 2009 was approximately $3.9 billion computed upon the basis of the closing sales price of the Class A Ordinary Shares on June 30, 2009. For purposes of this computation, ordinary shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 25, 2010, there were outstanding 342,142,419 Class A Ordinary Shares, $0.01 par value per share, of the registrant.

Documents Incorporated by Reference

The Registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report relating to the annual meeting of ordinary shareholders to be held on April 30, 2010 is incorporated by reference into Part III of this Form 10-K.

XL CAPITAL LTD
TABLE OF CONTENTS

		Page
	PART I	
Item 1.	Business	1
Item 1A.	Risk Factors	29
Item 1B.	Unresolved Staff Comments	51
Item 2.	Properties	52
Item 3.	Legal Proceedings	52
Item 4.	Reserved	54
	PART II	
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	56
Item 6.	Selected Financial Data	58
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	60
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	126
Item 8.	Financial Statements and Supplementary Data	138
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.	243
Item 9A.	Controls and Procedures	243
Item 9B.	Other Information.	243
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance	244
Item 11.	Executive Compensation	244
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	244
Item 13.	Certain Relationships and Related Transactions, and Director Independence	244
Item 14.	Principal Accounting Fees and Services	244
	PART IV	
Item 15.	Exhibits, Financial Statement Schedules	245

This Annual Report on Form 10-K contains Forward-Looking Statements as defined in the Private Securities Litigation Reform Act of 1995. A non-exclusive list of the important factors that could cause actual results to differ materially from those in such Forward-Looking Statements is set forth herein under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

PART I

ITEM 1. BUSINESS

History

XL Capital Ltd, through its subsidiaries (the Company or XL), is a global insurance and reinsurance company providing property, casualty and specialty products to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. XL Capital Ltd was incorporated with limited liability under the Cayman Islands Companies Act on March 16, 1998, as EXEL Merger Company. XL Capital Ltd was formed as a result of the merger of EXEL Limited and Mid Ocean Limited on August 7, 1998, and the Company was named EXEL Limited on that date.

EXEL Limited and Mid Ocean Limited are companies that were incorporated in the Cayman Islands with principal operations in Bermuda in 1986 and 1992, respectively. Exel Limited and its subsidiaries were formed in response to a shortage of high excess liability underwriting capacity in the insurance industry at that time and included a subsidiary organized in Ireland to serve the European Community. Mid Ocean Limited and its subsidiaries were formed to capitalize on the supply/demand imbalance in the global property catastrophe reinsurance market at that time and included dedicated Lloyd s syndicate capacity. At a special general meeting held on February 1, 1999, the shareholders of the Company approved a resolution changing the name of the Company to XL Capital Ltd.

On June 18, 1999, XL Capital Ltd merged with NAC Re Corp. (NAC), a Delaware corporation organized in 1985, in a stock merger. This merger was accounted for as a pooling of interests under U.S. generally accepted accounting principles (GAAP). Following the merger, the Company changed its fiscal year end from November 30 to December 31 as a conforming pooling adjustment.

On July 25, 2001, the Company acquired certain Winterthur International insurance operations (Winterthur International) to extend its predominantly North American-based large corporate insurance business globally. Results of operations of Winterthur International have been included from July 1, 2001, the date from which the economic interest was transferred to the Company.

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

On August 4, 2006, the Company completed the sale of approximately 37% of its then financial guarantee reinsurance and insurance businesses through an initial public offering (IPO) of 23.4 million common shares of Syncora Holdings Ltd. (Syncora) (formerly Security Capital Assurance Ltd. or SCA). On June 6, 2007, the Company completed the sale of a portion of Syncora s common shares still owned by the Company through a secondary offering and thereby reduced its ownership of Syncora s outstanding common shares further from approximately 63% to approximately 46%. On August 5, 2008, the Company closed an agreement (the Master Agreement) with Syncora and its subsidiaries, as well as certain counterparties to credit default swap agreements, in connection with the termination of certain reinsurance and other agreements. As part of the Master Agreement, the Company transferred all of the shares it owned in Syncora to a trust and as a result has no further ownership interest in the company. For further details relating to the Master Agreement, see Item 8, Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd.

On January 12, 2010 the Company announced a proposal to change the place of incorporation of the ultimate parent holding company of XL from the Cayman Islands to Ireland, through a scheme of arrangement under Cayman Islands law. Shareholders will be asked to vote in favor of completing the redomestication and proposals relating thereto at a special court-ordered class meeting and an extraordinary general meeting of the ordinary shareholders. If the necessary conditions are satisfied, including approval by the ordinary shareholders and by the Grand Court of the Cayman Islands, shares of XL Capital Ltd

(referred to as XL-Cayman in the context of the redomestication) will be cancelled and shareholders will receive, on a one-for-one basis, new ordinary shares of XL Group plc (XL-Ireland), and XL-Ireland will replace XL-Bermuda as the ultimate parent company of XL. The Company s Board of Directors has unanimously determined that changing the place of incorporation of the ultimate parent company to Ireland, and the other related proposals, are in the best interests of the Company and its shareholders. Subject to satisfaction of the various conditions, the change of the Company s place of incorporation is currently expected to become effective on July 1, 2010.

In connection with the proposed redomestication, the Company will also seek the approval of the Series C and Series E preference shareholders of XL-Cayman to exchange their preference shares for an equal number of preference shares of XL-Ireland in the scheme of arrangement. Even if approval of the preference shareholders is obtained, this preference share exchange will occur only if the redomestication is consummated and the ordinary shares are exchanged as described above. The redomestication is not conditioned on completion of the preference share exchange or any approval by Series C or Series E preference shareholders.

Additional information regarding the redomestication, is included in the Preliminary Proxy Statement on Schedule 14A filed with the SEC on January 12, 2010 (the Redomestication Proxy Statement). A definitive Proxy Statement will be sent to ordinary shareholders in advance of the relevant shareholder meetings.

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

Segments

Following the streamlining of the Company s operating segments in the first quarter of 2009, the Company is organized into three operating segments: Insurance, Reinsurance and Life Operations. The general investment and financing operations of the Company are reflected in Corporate.

The Company evaluates the performance for both the Insurance and Reinsurance segments based on underwriting profit and evaluates the contribution from the Life Operations. Other items of revenue and expenditure of the Company are not evaluated at the segment level for reporting purposes. In addition, the Company does not allocate investment assets by segment for its 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 are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these operations.

The following table sets forth an analysis of gross premiums written by segment for the years ended December 31, 2009, 2008 and 2007. Additional financial information about the Company s segments, including financial information about geographic areas, is included in Item 8, Note 6 to the Consolidated Financial Statements, Segment Information.

Year ended December 31 *(U.S. dollars in thousands)*	**2009 Gross Premiums Written**	**Percentage Change**	**2008 Gross Premiums Written**	**Percentage Change**	**2007 Gross Premiums Written**
Insurance	$ 4,251,888	(19.9)%	$ 5,308,914	(2.3)%	$ 5,434,266
Reinsurance	1,859,423	(17.7)%	2,260,477	(15.1)%	2,663,494
Life Operations	576,162	(16.6)%	690,915	(7.0 %	743,220
Syncora (1)		%		(100.0)%	156,983

$ 6,687,473	(19.0)%	$ 8,260,306	(8.2)%	$ 8,997,963

(1) Gross premiums written relating to Syncora in 2007 are for the period from January 1, 2007 through June 6, 2007, the date on which the Company completed the sale of a portion of Syncora s common shares then owned by the Company, through a secondary offering and thereby reduced its ownership of Syncora s outstanding common shares from approximately 63% to approximately 46%. From June 6, 2007 until the execution of the Master Agreement, the Company accounted for its remaining investment in

Syncora using the equity method of accounting. Subsequent to August 5, 2008, the Company has no further ownership interest in Syncora.

Insurance Segment

General

The Company s Insurance segment provides commercial property, casualty and specialty insurance products on a global basis. Products generally provide tailored coverages for complex corporate risks and include the following lines of business: property, casualty, professional liability, environmental liability, aviation and satellite, marine and offshore energy, equine, fine art and specie, excess and surplus lines and other insurance coverages including program business. However, given the changing economic environment that has been experienced throughout 2008 and 2009 during the global economic and financial crises, and following the significant impacts to the Company during 2008, including the downgrade of the financial strength ratings of the Company s leading insurance and reinsurance subsidiaries by leading rating agencies, the Company focused on those lines of business within its insurance operations that are believed to provide the best return on capital. For the Insurance segment, this included the non-renewal of certain insurance programs, as well as a continued reduction in long-term agreements.

Property and casualty products are typically written as global insurance programs for large multinational companies and institutions and include umbrella liability, product recall, U.S. workers compensation, property catastrophe and primary master property and liability coverages. Property and casualty products generally provide large capacity on a primary, quota share or excess of loss basis. Global insurance programs are targeted to large worldwide companies in major industry groups including aerospace, automotive, consumer products, pharmaceutical, pulp and paper, high technology, telecommunications, transportation and basic metals. In North America, the casualty business written includes primary, umbrella and high layer excess business. The primary casualty programs (including workers compensation) generally require customers to take large deductibles or self-insured retentions. For the umbrella and excess business written, the Company s liability attaches after large deductibles, including self insurance or insurance from other companies. Outside of North America, casualty business is generally written on a primary or excess basis. Policies are written on an occurrence, claims-made and occurrence reported basis. The Company s property business written, which also includes construction projects, is short-tail by nature and written on both a primary and excess of loss basis. Property business written includes exposures to man-made and natural disasters, and generally, loss experience is characterized as low frequency and high severity. This may result in volatility in the Company s results of operations, financial condition and liquidity. In addition to the property and casualty products noted above, in 2008 the Company launched underwriting capabilities for the Upper Middle Markets (UMM) in the U.S., U.K. and Continental Europe. These units are focused on providing underwriting expertise and tailored insurance solutions for the UMM customers through focused distribution channels of select regional retail brokers. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , for further information.

Professional liability insurance includes directors and officers liability, errors and omissions liability and employment practices liability coverages. Policies are written on both a primary and excess of loss basis. Directors and officers coverage includes primary and excess directors and officers liability, employment practices liability, company securities and private company directors and officers liability. Products are targeted at a variety of different sized companies, with a heavy concentration on small to medium-sized firms when written on a primary basis. Employment practices liability is written primarily for very large corporations on an excess of loss basis and covers those firms for legal liability in regard to the treatment of employees. Errors and omissions coverage is written on a primary and excess basis. Errors and omissions insurance written on a primary basis is targeted to small and medium-sized firms and coverage is provided for various professional exposures, including, but not limited to, insurance brokers, consultants, architects and engineers, lawyers, public entities and real estate agents.

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

commercial general liability and automobile liability insurance to environmental businesses.

Aviation and satellite products include comprehensive airline hull and liability, airport liability, aviation manufacturers product liability, aviation ground handler liability, large aircraft hull and liability, corporate

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

Marine and offshore energy, equine and fine art and specie insurance are also provided by the Company. Marine and energy coverage includes marine hull and machinery, marine war, marine excess liability, cargo and offshore energy insurance. Equine products specialize in providing bloodstock, livestock and aquaculture insurance. Fine art and specie coverages include fine art, jewelers block, cash in transit and related coverages for financial institutions.

Excess and surplus lines products include both general liability and property coverages. For general liability, most Insurance Services Office, Inc. (ISO) products are written. For property, limits are relatively low and coverages exclude flood, earthquake and difference in conditions. In 2009 the Company decided to stop offering property coverages.

The Company s program business specializes in insurance coverages for distinct market segments in North America, including program administrators and managing general agents who operate in a specialized market niche and have unique industry backgrounds or specialized underwriting capabilities. Products encompass automobile extended warranty and other property and casualty coverages. The Company implemented an exit strategy to exit the automobile extended warranty business in 2009.

Certain structured indemnity products, previously structured by XL Financial Solutions (XLFS), are included within the results of the Insurance segment covering a range of insurance risks including property and casualty insurance, certain types of residual exposures and other market risk management products. In August 2008, the Company ceased certain operations that included the closure of the XLFS business unit and reassignment of responsibility for existing structured indemnity business to either the Insurance or Reinsurance segment depending on the underlying nature of the transactions.

Also included as part of the Insurance segment is XL Global Asset Protection Services (XL GAPS), a fee for service loss prevention consulting service which offers individually tailored risk management solutions to risk managers, insurance brokers and insurance company clients operating on a global basis.

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

U.S. Terrorism

The U.S. Terrorism Risk Insurance Act of 2002 (TRIA), as amended, established the Terrorism Risk Insurance Program (TRIP) which became effective on November 26, 2002 and was a three-year federal program effective through 2005. On December 22, 2005, President George W. Bush signed a bill extending TRIA (TRIAE) for two more years, continuing TRIP through 2007. On December 26, 2007, President George W. Bush signed the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) which further extended TRIP for 7 years until December 31, 2014 and also eliminated the distinction between foreign and domestic acts of terrorism.

TRIA voided in force terrorism exclusions as of November 26, 2002 for certified terrorism on all TRIA specified property and casualty business. TRIA required covered insurers to make coverage available for certified acts of terrorism (other than nuclear, biological, radiological and chemical, or NBRC) on all new and renewal policies issued after TRIA was enacted. Legislation approved under TRIP, as noted above, allows the Company to assess a premium charge for terrorism coverage and, if the policyholder declines the coverage or fails to pay the buy-back premium, certified acts of terrorism will then be excluded from the policy, subject, however, to state specific requirements. Terrorism coverage cannot be excluded from workers compensation policies. Subject to a premium-based deductible and provided that the Company has otherwise complied with all the requirements as specified under TRIPRA, the Company is eligible for reimbursement by the Federal Government for up to 85% of its covered terrorism-related losses arising from a certified terrorist attack. Such payment by the government will, in effect, provide reinsurance

protection on a quota share basis. The maximum liability during a program year, including both the Federal Government s and insurers shares, is capped on an aggregated basis at $100 billion.

The Company had, prior to the passage of TRIP and the related legislation, underwritten exposures under certain insurance policies that included coverage for terrorism. The passage of TRIP and the related legislation, has required the Company to make a mandatory offer of Certified terrorism coverage with respect to relevant covered insurance policies as specified under the related legislation.

Non-U.S. Terrorism

The Company provides coverage for terrorism outside of the United States under casualty policies on a case-by-case basis. The Company generally does not provide significant limits of coverage for terrorism under first party property policies outside of the U.S. unless required to do so by local law, or as required to comply with any national terrorism risk pool which may be available. Various countries have enacted legislation to provide insurance coverage for terrorism occurring within their borders, to protect registered property, and to protect citizens traveling abroad. The legislation typically requires registered direct insurers to provide terrorism coverage for specified coverage lines and then permits them to cede the risk to a national risk pool. The Company has subsidiaries that participate in terrorism risk pools in various jurisdictions, including Australia, France, Spain, the Netherlands and the United Kingdom.

Underwriting

The Company underwrites and prices most risks individually following a review of the exposure and in accordance with the Company s underwriting guidelines. Most of the Company s insurance operations have underwriting guidelines that are industry-specific. The Company seeks to serve its client s while controlling its exposure on individual insurance contracts through terms and conditions, policy limits and sublimits, attachment points, and facultative and treaty reinsurance arrangements on certain types of risks.

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

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

As the Company s insurance products are primarily specialized coverages, underwriting guidelines and policy forms differ by product offering as well as by legal jurisdiction. Liability insurance is written on both a primary and excess of loss basis, on occurrence, occurrence reported and claims-made policy forms. Occurrence reported policies typically cover occurrences causing unexpected and unintended personal injury or property damage to third parties arising from events or conditions that commence at or subsequent to an inception date, or retroactive date, if applicable, and prior to the expiration of the policy provided that proper notice is given during the term of the policy or the discovery period. Claims made policies typically cover only claims made during the policy period or extended reporting period and are generally associated with professional liability coverages. Traditional occurrence coverage is also available for restricted classes of risk and is generally written on a follow-form basis where the policy adopts the terms, conditions and exclusions of the underlying policy. Property insurance risks are written on a lead or follow-form basis that usually provides coverage for all risks of physical damage and business interruption. Maximum

limits are generally subject to sublimits for coverage in critical earthquake and flood zones, where the Company seeks to limit its liability in these areas.

Reinsurance Ceded

In certain cases, the risks assumed by the Company in the Insurance segment are partially reinsured with third party reinsurers. Reinsurance ceded varies by location and line of business based on a number of

factors, including market conditions. The benefits of ceding risks to third party reinsurers include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. Reinsurance ceded does not legally discharge the Company from its liabilities to the original policyholder in respect of the risk being reinsured.

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

Premiums

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

The following table is an analysis of the Insurance segment s gross premiums written, net premiums written and net premiums earned, by line of business for the year ended December 31, 2009:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Casualty professional lines	$ 1,423,756	$ 1,336,541	$ 1,276,005
Casualty other lines	947,121	570,887	655,126
Other property	649,592	361,841	426,441
Marine, energy, aviation and satellite	644,898	516,408	546,806
Other specialty lines (1)	577,804	483,166	634,436
Other (2)	5,257	1,077	12,217
Structured indemnity	3,460	3,460	8,762
Total	$ 4,251,888	$ 3,273,380	$ 3,559,793

(1) Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, specie, middle markets and

excess and surplus lines.

(2) Other includes credit and surety and other lines.

Competition

The Company competes globally in the property and casualty insurance markets. Its competitors include the following companies and their affiliates: The ACE Group of Companies (ACE); Allianz Aktiengesellschaft (Allianz); American International Group, Inc. primarily their Chartis subsidiary (AIG); Factory Mutual Global (FMG) for property only; Hartford Financial Services (Hartford); Lloyd s of London Syndicates (Lloyd s); The Chubb Corporation (Chubb); T Travelers Companies (Travelers); and Zurich Financial Services Group (Zurich).

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

North America AIG, ACE, Chubb, FMG, Zurich, Travelers, CNA Financial Corporation, Hartford, Liberty Mutual Group and Lloyd s.

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

Bermuda ACE, Allied World Assurance Company (AWAC), Axis Capital Group (Axis), Max Re Ltd. (Max Re), Endurance Specialty Insurance Ltd (Endurance) and Arch Capital Group Ltd (Arch).

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview for further discussion.

Marketing and Distribution

The majority of Insurance Segment business originates via a large number of international, national and regional producers, acting as the brokers and representatives of current and prospective policyholders. A portion of Insurance Segment business is marketed and underwritten by general agents and independent agents acting on behalf of the Company. Typically, all such producers, general agents, and independent

agents receive commission payments from the Company for their services, which payments are calculated as a percentage of gross premium paid by the policyholder on an account-by-account basis. A certain portion of business originating from producers is submitted on a fee basis under which the producer is compensated by a fee paid to it by its policyholder client. From time to time, the Company also considers requests for commissions from a producer, with disclosure by the producer to the policyholder-client, where the producer receives a fee from the policyholder-client. The Company evaluates such requests on a case-by-case basis.

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

With regard to excess and surplus lines business, the Company receives submissions from licensed wholesale surplus lines brokers.

The Company has no implied or explicit commitments to accept business from any particular broker, and neither producers nor any other third party have the authority to bind the Company, except in the case where underwriting authority may be delegated contractually to selected general agents. Such general agents are subject to a financial and operational due diligence review prior to any such delegation of authority and ongoing reviews and audits are carried out as deemed necessary by the Company with the goal of assuring the continuing integrity of underwriting and related business operations. See Item 8, Note 20(a) to the Consolidated Financial Statements for information on the Company s major producers, Commitments and Contingencies Concentrations of Credit Risk.

Apart from compensation arrangements established with producers in connection with insurance transactions, the Company also has engaged, and may in the future engage, certain producers or their affiliates in consulting roles pursuant to which such producers provide access to certain systems and information that may assist the Company with its marketing and distribution strategy. In instances where the Company engages producers in such consulting roles, the Company may compensate the relevant producers on a fixed fee basis, a variable fee basis based upon Company usage of the systems and information proffered, or through a combination of fixed and variable fee.

Structure of Insurance Operations

In October 2009, the Company s insurance operations were reorganized into four business units: Global Professional Lines, Global Specialty Lines, North America Property and Casualty and International Property and Casualty. This new simplified structure has had no impact on the Company s client facing activities but provides increased authority and accountability to each business unit leader. The Company operated under its product and geography based matrix business structure up to October 2009.

The segment s most significant operating legal entities during 2009 were as follows: XL Insurance (Bermuda) Ltd, XL Insurance Company Limited, XL Specialty Insurance Company, Indian Harbor Insurance Company, Greenwich Insurance Company, XL Insurance Switzerland as well as certain Lloyds Syndicates.

Claims Administration

Claims management for the insurance operations includes the review of initial loss reports, administration of claims databases, generation of appropriate responses to claims reports, identification and handling of coverage issues, determination of whether further investigation is required and, where appropriate, retention of claims counsel, establishment of case reserves, payment of claims and notification to reinsurers. With respect to the establishment of case reserves, when the Company is notified of insured losses, claims personnel record a case reserve as appropriate for the estimated amount of the exposure at that time. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim

and, where appropriate, advice of counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process.

Claims in respect of business written by the Company s Lloyd s syndicates are primarily notified by various central market bureaus. Where a syndicate is a leading syndicate on a Lloyd s policy, its underwriters and claims adjusters will deal with the broker or insured on behalf of itself and the following

market for any particular claim. This may involve appointing attorneys or loss adjusters. The claims bureaus and the leading syndicate advise movement in loss reserves to all syndicates participating on the risk. The Company s claims department may adjust the case reserves it records from those advised by the bureaus as deemed necessary.

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

In February 2010 and after over two years of design and development, the insurance operations has started deploying a new claims IT platform, called XL GlobalClaim (GCS). The Bermuda operations will serve as a pilot office with GCS being deployed throughout 2010 to the U.S. operations and Europe and Asia in the first quarter of 2011. GCS will convert the claim operation to a paperless environment and connect legacy systems to allow for consistent data aggregation for all global claims operations.

Reinsurance Segment

General

The Company s Reinsurance segment provides casualty, property risk (including energy and engineering), property catastrophe, marine, aviation, and other specialty reinsurance on a global basis with business being written on both a proportional and non-proportional basis and in certain limited instances on a direct basis. Given the changing economic environment that has been experienced throughout 2008 and early 2009 including the downgrade of the financial strength ratings of the Company s leading insurance and reinsurance subsidiaries by leading rating agencies, the Company shifted its focus to those lines of business within its reinsurance operations that provide the best return on capital. For the Company s Reinsurance segment this resulted, in certain instances, in a greater emphasis being placed on short-tail lines of business.

Business written on a non-proportional basis generally provides for an indemnification by the Company to the ceding company for a portion of losses both individually and in the aggregate, on policies with limits in excess of a specified individual or aggregate loss deductible. For business written on a proportional bases including quota share or surplus basis, the Company receives an agreed percentage of the premium and is liable for the same percentage of each and all incurred loss. For proportional business, the ceding company normally receives a ceding commission for the premiums ceded and may also, under certain circumstances, receive a profit commission. Occasionally this commission could be on a sliding scale depending on the loss ratio performance in which case there is generally no profit commission. The Company s casualty reinsurance includes general liability, professional liability, automobile and workers compensation. Professional liability includes directors and officers , employment practices, medical malpractice, and environmental liability. Casualty lines are written as treaties, programs as well as on an individual risk basis and on both a proportional and a non-proportional basis. The treaty business includes clash programs which cover a number of underlying policies involved in one occurrence or a judgment above an underlying policy s limit, before suffering a loss.

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

The Company seeks to manage its reinsurance exposures to catastrophic events by limiting the amount of exposure written in each geographic or peril zone worldwide, underwriting in excess of varying attachment points and requiring

that contracts exposed to catastrophe loss include aggregate limits. The Company also seeks to protect its total aggregate exposures by peril and zone through the purchase of reinsurance programs.

The Company s property catastrophe reinsurance account is generally all risk in nature. As a result, the Company is exposed to losses from sources as diverse as hurricanes and other windstorms, earthquakes, freezing, riots, floods, industrial explosions, fires, and many other potential natural or man-made disasters.

In accordance with market practice, the Company s policies generally exclude certain risks such as war, nuclear contamination or radiation. Following the terrorist attacks at the World Trade Center in New York City, in Washington, D.C. and in Pennsylvania on September 11, 2001 (collectively, the September 11 event), terrorism cover, including NBRC has been restricted or excluded in many territories and classes. Some U.S. states make it mandatory to provide some cover for Fire Following terrorism and some countries make terrorism coverage mandatory. The Company s predominant exposure under such coverage is to property damage.

The Company had, prior to the passing of TRIA, underwritten reinsurance exposures in the U.S. that included terrorism coverage. Since the passage of TRIA in the U.S., together with the TRIAE and TRIPRA extensions noted above, the Company has underwritten a very limited number of stand-alone terrorism coverage policies in addition to coverage included within non-stand-alone policies. In the U.S., in addition to NBRC acts, the Company generally excludes coverage included under TRIA from the main catastrophe exposed policies. In other cases, both within and outside the U.S., the Company generally relies on either a terrorism exclusion clause, which does not include personal lines, excluding NBRC, or a similar clause that excludes terrorism completely. There are a limited number of classes underwritten where no terrorism exclusion exists.

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

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

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

Underwriting

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

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

For property catastrophe reinsurance business, the Company s underwriting guidelines generally limit the amount of exposure it will directly underwrite for any one reinsured and the amount of the aggregate exposure to catastrophic losses in any one geographic zone. The Company believes that it has defined geographic and peril zones such that a single occurrence, for example an earthquake or hurricane, should not affect more than one peril zone. While the exposure to multiple zones is considered remote for events such as a hurricane, the Company does manage its aggregate exposures for such a scenario where the Company considers it appropriate to do so. The definition of the

Company s peril zones is subject to periodic review. The Company also generally seeks an attachment point for its property catastrophe reinsurance at a level that is high enough to produce a low frequency of loss. The Company seeks to limit its aggregate exposure in the proportional business through extensive use of occurrence and cession limits.

Reinsurance Retroceded

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

Effective January 1, 2008, the Company entered into a quota share reinsurance treaty with a newly-formed Bermuda reinsurance company, Cyrus Re II. Pursuant to the terms of the quota share reinsurance treaty, Cyrus Re II assumed a 10% cession of certain lines of property catastrophe reinsurance and retrocession business underwritten by certain operating subsidiaries of the Company for business that incepted between January 1, 2008 and July 1, 2008. In connection with such cessions, the Company paid Cyrus Re II reinsurance premium less a ceding commission, which included a reimbursement of direct acquisition expenses incurred by the Company as well as a commission to the Company for generating the business. The quota share reinsurance treaty also provided for a profit commission payable to the Company. The quota share with Cyrus Re II was canceled after its original term and not renewed.

The Company s traditional catastrophe retrocession program was renewed in June 2009 to cover certain of the Company s exposures. These protections, in various layers and in excess of varying attachment points according to the territory exposed, assist in managing the Company s net retention to an acceptable level. The Company has co-reinsurance retentions within this program. The Company renewed additional structures with a restricted territorial scope for 12 months at July 2009. The Company continued to buy additional protection for the Company s marine and offshore energy exposures. These covers provide protection in various layers and excess of varying attachment points according to the scope of cover provided. The Company has co-reinsurance participations within this program.

The Company continues to buy specific reinsurances on its credit and bond, motor third party liability, property and aviation portfolios to manage its net exposures in these classes.

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 13 to the Consolidated Financial Statements Reinsurance for further information.

Premiums

The following table is an analysis of the Reinsurance segment s gross premiums written, net premiums written and net premiums earned, by line of business for the year ended December 31, 2009:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Casualty professional lines	$ 170,928	$ 166,903	$ 196,624
Casualty other lines	218,778	217,889	257,610
Property catastrophe	357,267	312,321	312,780
Other property	862,310	553,556	560,379
Marine, energy, aviation and satellite	89,100	82,393	83,532
Other (1)	156,092	132,322	172,588

Structured indemnity	4,948	4,948	8,433
Total	$ 1,859,423	$ 1,470,332	$ 1,591,946

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

Additional discussion and financial information about the Reinsurance segment is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 6 to the Consolidated Financial Statements, Segment Information.

Competition

The Company competes globally in the property and casualty markets.

The Company s major geographical markets for its property and casualty reinsurance operations are North America, Europe, Bermuda and Emerging Markets (covering Asia/Pacific and South America). The main competitors in each of these markets include the following:

North America Berkshire Hathaway, Munich Re Corporation, Swiss Re America Corporation, Transatlantic Re, Everest Re Group Ltd, Hannover Re, and PartnerRe Ltd.

Europe Munich Re, Swiss Re, Lloyd s, SCOR Reinsurance Company, and PartnerRe Ltd.

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

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview for further discussion.

Marketing and Distribution

See Insurance Segment Marketing and Distribution and Item 8, Note 20(a) to the Consolidated Financial Statements, Commitments and Contingencies Concentrations of Credit Risk for information in the Company s marketing and distribution procedures and information on the Company s major brokers.

Structure of Reinsurance Operations

The Company s reinsurance operations are structured geographically into Bermuda operations, North American operations, European/Asia Pacific operations and Latin American operations.

The segments most significant operating legal entities during 2009 were as follows: XL Reinsurance America Inc., XL Re Ltd, XL Re Europe Limited and XL Re Latin America Ltd.

Claims Administration

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

Life Operations Segment

During 2009, the Company completed a strategic review of its life reinsurance business. In relation to this initiative, the Company sold the renewal rights to its Continental European short-term life, accident and health business in December 2008. The Company also announced in March 2009 that it would run-off its existing book of U.K. and Irish traditional life and annuity business, and not accept new business. In addition, during July 2009, the Company entered into an agreement to sell its U.S. life reinsurance business. The transaction closed during the fourth quarter of 2009. In December 2009, the Company entered into an agreement to novate and recapture a number of U.K. and Irish term assurance and critical illness treaties. The transaction closed during the fourth quarter of 2009.

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

Products offered included a broad range of underlying lines of life insurance business, including term assurances, group life, critical illness cover, immediate annuities and disability income. In addition, prior to selling the renewal rights, the products offered included short-term life, accident and health business. The segment also covers a range of geographic markets, with an emphasis on the U.K., U.S., Ireland and Continental Europe.

The portfolio has three particularly significant components:

1) The portfolio includes a small number of large contracts relating to closed blocks of U.K. and Irish fixed annuities in payment. In relation to certain of these contracts, the Company receives cash and

investment assets at the inception of the reinsurance contract, relating to the future policy benefit reserves assumed. These contracts are long-term in nature, and the expected claims payout period can span up to 30 or 40 years with average duration of around 10 years. The Company is exposed to investment and survivorship risk over the life of these arrangements.

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

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

Underwriting & Claims Administration

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

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

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

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

The team includes many members with specialized actuarial and medical underwriting knowledge. Claims administration also relies on experience and specific medical expertise.

The Company maintains comprehensive terms of trade guidelines for all core product lines, which are regularly monitored and refined. These guidelines describe the approach to be taken in assessing and underwriting opportunities, including the approach to be taken to the setting of core parameters and to the determination of appropriate pricing levels. The terms of trade are overseen by a separate team from the new business underwriters.

In addition, the Company maintains a medical underwriting manual which sets out the approach to be taken to underwriting specific medical impairments when setting terms for a new business treaty.

Reinsurance Retroceded

The Company purchases limited retrocession capacity on a per-life basis in the U.S. and Continental Europe in order to cap the maximum claim arising from the death of a single individual. Cover is purchased from professional retrocessionaires which meet the Company s criteria for counterparty exposures. Limited retrocession of fixed annuity business has also been used to manage aggregate longevity capacity on specific deals.

Premiums

The following table is an analysis of the Life Operations gross premiums written, net premiums written and net premiums earned for the year ended December 31, 2009:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Other Life	$ 413,831	$ 400,345	$ 422,594
Annuity	162,331	132,507	132,507
Total	$ 576,162	$ 532,852	$ 555,101

Additional discussion and financial information about the Life Operations is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 6 to the Consolidated Financial Statements, Segment Information.

Competition

In regards to the Life Operations segment, the core activity is in the U.S., U.K., Ireland and Continental Europe. While the Company no longer competes for new business, it retains an in-force portfolio and hence views companies with similar portfolios as competitors.

Within the new business treaty area, competition includes amongst others: Swiss Re; Munich Re; Reinsurance Group of America; Hannover Re; Transamerica Re; and General Re.

For the fixed annuity business, competition has historically come from less traditional reinsurance entities, such as Canada Life and Prudential (U.K.) or recently established entities such as Paternoster, Synesis, and PIC. However, in recent years, more traditional reinsurance players, in particular Swiss Re, have entered or re-entered this market.

Marketing and Distribution

The Company predominantly marketed its long-term products directly to clients, with a smaller element sourced through reinsurance intermediaries. The Company primarily marketed the short-term life, accident and health business through reinsurance intermediaries. Following the closure to new business and the sale of the renewal rights, the Company has ceased to market these product lines.

The Company s distribution strategy has been to avoid any undue concentration on any single client or market. Efforts were made to target ceding companies that were themselves strong and growing in their target segments.

Other Financial Lines Business

Following the streamlining of the Company s operating segments in the first quarter of 2009, the Other Financial Lines business is now included in Corporate. The Other Financial Lines Business is comprised of remaining contracts associated with the funding agreement (FA) business and previously included the guaranteed investment contract (GIC) business. GICs and FAs provide users guaranteed rates of interest on amounts previously invested with the Company. FAs are very similar to GICs in that they have known cash flows. FAs were sold to institutional investors, typically through medium term note programs. At December 31, 2009, the remaining balance of FAs, excluding accrued interest of $6.5 million, was $450 million, with settlements scheduled for $450 million in August 2010.

Unpaid Losses and Loss Expenses

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

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

The tables below present the development of the Company s unpaid losses and loss expense reserves on both a net and gross basis. The cumulative redundancy (deficiency) calculated on a net basis differs from that calculated on a gross basis. As different reinsurance programs cover different underwriting years, net and gross loss experience will not develop proportionately. The top line of the tables shows the estimated liability, net of reinsurance recoveries, as at the year end balance sheet date for each of the indicated years. This represents the estimated amounts of losses and loss expenses, including IBNR, arising

in the current and all prior years that are unpaid at the year end balance sheet date of the indicated year. The tables show the re-estimated amount of the previously recorded reserve liability based on experience as of the year end balance sheet date of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual years. The cumulative redundancy (deficiency) represents the aggregate change with respect to that liability originally estimated. The lower portion of the first table also reflects the cumulative paid losses relating to these reserves. Conditions and trends that have affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies into the future, based on the tables below. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Analysis of Losses and Loss Expense Reserve Development
Net of Reinsurance Recoveries

(U.S. dollars in millions)	**1999**	**2000**	**2001**	**2002**	**2003**	**2**
ESTIMATED LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES, NET OF REINSURANCE RECOVERABLES	$ 4,537	$ 4,207	$ 7,004	$ 8,313	$ 10,532	$
LIABILITY RE-ESTIMATED AS OF:						
One year later	4,142	4,382	7,404	9,250	10,800	
Two years later	4,085	4,345	8,423	9,717	11,842	
Three years later	4,120	5,118	8,653	10,723	11,849	
Four years later	4,624	5,294	9,727	10,738	11,860	
Five years later	4,747	5,435	9,674	10,710	11,680	
Six years later	4,858	5,419	9,718	10,642	11,794	
Seven years later	4,872	5,508	9,680	10,824		
Eight years later	4,927	5,496	9,921			
Nine years later	4,926	5,571				
Ten years later	4,942					
CUMULATIVE REDUNDANCY (DEFICIENCY) (1)	(405)	(1,364)	(2,917)	(2,511)	(1,262)	
CUMULATIVE PAID LOSSES, NET OF REINSURANCE RECOVERIES, AS OF:						
One year later	$ 1,252	$ 1,184	$ 2,011	$ 2,521	$ 1,985	$

Two years later	1,828	1,920	3,984	3,800	2,867
Three years later	2,306	2,683	4,703	4,163	4,380
Four years later	2,824	3,038	4,641	5,365	5,286
Five years later	3,035	3,290	5,526	6,018	6,225
Six years later	2,807	3,774	5,969	6,764	7,002
Seven years later	3,110	3,985	6,514	7,381	
Eight years later	3,240	4,351	6,965		
Nine years later	3,482	4,589			
Ten years later	3,608				

Analysis of Property and Casualty Losses and Loss Expense Reserve Development
Gross of Reinsurance Recoverables

(U.S. dollars in millions)	**1999**	**2000**	**2001**	**2002**	**2003**	**200**
ESTIMATED GROSS LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES	$ 5,369	$ 5,668	$ 11,807	$ 13,333	$ 16,553	$ 1
LIABILITY RE-ESTIMATED AS OF:						
One year later	$ 5,266	$ 6,118	$ 12,352	$ 15,204	$ 18,189	$ 1
Two years later	5,147	6,105	14,003	16,994	18,520	1
Three years later	5,176	6,909	15,377	17,210	18,324	1
Four years later	5,663	7,086	15,441	17,048	18,362	1
Five years later	5,798	7,240	15,267	17,106	18,236	1
Six years later	5,890	7,223	15,401	17,051	18,328	
Seven years later	5,881	7,317	15,381	17,189		
Eight years later	5,957	7,370	15,602			
Nine years later	5,960	7,460				
Ten years later	5,977					
CUMULATIVE REDUNDANCY (DEFICIENCY)	(608)	(1,792)	(3,795)	(3,856)	(1,775)	

(1) Excludes $351.0 million of financial guarantee reserves previously related to reinsurance agreements with Syncora.

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

Reconciliation of Unpaid Losses and Loss Expenses

(U.S. dollars in thousands)	**2009**	**2008**	**2007**
Gross unpaid losses and loss expenses at beginning of year	$ 21,650,315	$ 23,207,694	$ 22,895,021
Unpaid losses and loss expenses recoverable	3,964,836	4,665,615	4,995,373
Financial guarantee reserves related to previous reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates		(350,988)	
Net unpaid losses and loss expenses at beginning of year	17,685,479	18,191,091	17,899,648
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:			
Current year	3,453,577	4,573,562	4,266,444
Prior years	(284,740)	(610,664)	(425,441)
Total net incurred losses and loss expenses	3,168,837	3,962,898	3,841,003
Exchange rate effects	287,752	(677,664)	421,575
Net loss reserves (disposed) acquired (1)			(155,259)
Less net losses and loss expenses paid in respect of losses occurring in:			
Current year	439,638	584,120	627,748
Prior years	3,436,297	3,206,726	3,188,128
Total net paid losses	3,875,935	3,790,846	3,815,876
Net unpaid losses and loss expenses at end of year	17,266,133	17,685,479	18,191,091
Financial guarantee reserves related to previous reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates			350,988
Unpaid losses and loss expenses recoverable	3,557,391	3,964,836	4,665,615
Gross unpaid losses and loss expenses at end of year	$ 20,823,524	$ 21,650,315	$ 23,207,694

The Company s net unpaid losses and losses expenses relating to the Company s operating segments at December 31, 2009 and 2008 were as follows:

(U.S. dollars in millions)	**December 31, 2009**	**December 31, 2008**
Insurance	$ 11,128	$ 11,126
Reinsurance	6,138	6,559
Net unpaid loss and loss expense reserves	$ 17,266	$ 17,685

Current year net losses incurred

Net losses incurred decreased by $794.1 million in 2009 as compared to 2008, mainly as a result of the current year loss ratio decreasing by 9.4 loss percentage points during the same period. This decrease is due primarily to lower levels of large property risk and catastrophe losses occurring in 2009 combined with the impact of anticipated sub prime and credit related losses in 2008. The lower level of property losses in 2009 as well as business mix changes more than offset the impacts of a softening rate environment. The decrease in net losses incurred is also due to a reduction in business volume as net premiums earned decreased 14.0% in 2009 relative to 2008.

Net losses incurred increased by $307.1 million in 2008 as compared to 2007, mainly as a result, of the current year loss ratio increasing by 10.0 loss percentage points during the same period, mainly due to an increase in attritional and catastrophe-related property losses. Business volume reduced as net premiums earned related to the Company s P&C operations decreased by 6.7% over this period. Overall, windstorm activity in the Atlantic and Gulf regions increased in 2008 as compared to 2007 and included the impacts of Hurricanes Gustav and Ike, which both made landfall in the U.S. in the third quarter of 2008. Hurricane

Ike was estimated to have caused the third largest ever insured loss in the U.S. from a windstorm. Combined, Hurricanes Gustav and Ike had a significant impact on the results of the Company for the year ended December 31, 2008. In 2008, the Company incurred losses, net of reinsurance recoveries and reinstatement premiums, of $22.5 million and $210.0 million related to Hurricanes Gustav and Ike, respectively.

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

Prior year net losses incurred

The following tables present the development of the Company s gross and net, losses and loss expense reserves, excluding, for 2007, financial guarantee reserves related to previous reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates. The tables also show the estimated reserves at the beginning of each fiscal year and the favorable or adverse development (prior year development) of those reserves during such fiscal year.

Gross *(U.S. dollars in millions)*	**2009**	**2008**	**2007**
Unpaid losses and loss expense reserves at the beginning of the year	$ 21,650	$ 22,857	$ 22,895
Net (favorable) adverse development of those reserves during the year	(302)	(1,054)	(437)
Unpaid losses and loss expense reserves re-estimated one year later	$ 21,348	$ 21,803	$ 22,458

Net *(U.S. dollars in millions)*	**2009**	**2008**	**2007**
Unpaid losses and loss expense reserves at the beginning of the year	$ 17,686	$ 18,191	$ 17,900
Net (favorable) adverse development of those reserves during the year	(285)	(611)	(425)
Unpaid losses and loss expense reserves re-estimated one year later	$ 17,401	$ 17,580	$ 17,475

In 2009, gross prior year favorable development was in line with net favorable development in both the Insurance and Reinsurance segments. In 2008, gross prior year favorable development exceeded net prior year favorable development in both the Reinsurance and Insurance segments. Within the Reinsurance segment, the gross impact of favorable loss experience related to a large crop program was mostly offset by the impact of retrocessional protection related to this program. In the Insurance segment, the impact of reductions in gross reported losses on older years in certain casualty lines was mostly offset by the impact of the reinsurance recoverable component on such losses, while the impact of gross reserve releases in professional and specialty lines was mostly offset by the impact of a reduction in estimated ceded IBNR following a reserve review in these lines.

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

(U.S. dollars in millions)	**2009**	**2008**	**2007**
Insurance segment	$ (62.9)	$ (305.5)	$ (158.1)
Reinsurance segment	(221.8)	(305.2)	(267.3)
Total	$ (284.7)	$ (610.7)	$ (425.4)

The Company had net favorable prior year reserve development in property and casualty operations of $284.7 million, $610.7 million and $425.4 million for the years ending December 31, 2009, 2008 and 2007, respectively. See the Income Statement Analysis at Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 12 to the Consolidated Financial Statements, Losses and Loss Expenses , for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of the Company s operating segments.

Net loss reserves (disposed) acquired

The Company did not dispose of or acquire net loss reserves in 2009 or 2008.

Net losses disposed in the amount of $155.3 million in 2007 represent reserves associated with the de-consolidation of Syncora following the secondary offering on June 6, 2007 of $181.4 million, partially offset by net losses acquired of $26.2 million related to a reinsurance to close loss portfolio transfer.

Exchange rate effects

Exchange rate effects on net loss reserves in each of the three years ended December 31, 2009 related to the global operations of the Company primarily where reporting units have a functional currency that is not the U.S. dollar. The decrease in the value of the U.S. dollar in 2009 and 2007 combined with the increase in the value of the U.S. dollar in 2008 mainly compared to the Swiss franc, U.K. Sterling and the Euro, gave rise to translation and revaluation exchange movements related to carried loss reserve balances of $287.8 million, ($677.7) million and $421.6 million in 2009, 2008 and 2007, respectively.

Net paid losses

Total net paid losses were $3.9 billion in 2009 and $3.8 billion in each of 2008 and 2007. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for further information.

Other loss related information

The Company s net incurred losses and loss expenses include actual and estimates of potential non-recoveries from reinsurers. As at December 31, 2009 and 2008, the reserve for potential non-recoveries from reinsurers was $189.8 million and $187.6 million, respectively. For further information, see Note 13 to the Consolidated Financial Statements, Reinsurance.

Except for certain workers compensation the Company does not discount its unpaid losses and loss expenses. The Company utilizes tabular reserving for workers compensation unpaid losses that are considered fixed and determinable, and discounted such losses using an interest rate of 5% in 2009 and 2008. The tabular reserving methodology associated with workers compensation liabilities results in applying uniform and consistent criteria for establishing expected future indemnity and medical payments (including an explicit factor for inflation) and the use of mortality tables to determine expected payment periods. Tabular unpaid losses and loss expenses, net of reinsurance, at December 31, 2009 and 2008 were $734.1 million and $755.8 million, respectively. The related discounted unpaid losses and loss expenses were $343.7 million and $346.0 million as of December 31, 2009 and 2008, respectively.

Investments

Investment structure and strategy

The Company s investment operations are managed centrally by the Company s Investment Group. The Finance Committee of the Board of Directors of the Company approves overall investment policy and guidelines, and reviews the implementation of the investment strategies on a regular basis.

Strategic Asset Allocation

During 2008, management initiated a Strategic Asset Allocation (SAA) project that resulted in the development of an asset allocation benchmark for its property insurance, casualty insurance and reinsurance operations (P&C). This project was a stochastic dynamic financial analysis (DFA) model of investment assets and liabilities by major line of business to changes in underlying economic variables (including interest rates, inflation and GDP). The final benchmark that was selected by management is believed to maximize the Company s enterprise value, over the strategic planning period, subject to accounting, regulatory, capital and risk tolerance constraints. The Company is now focusing on optimizing the P&C investment portfolio through the process of an orderly transition towards the

SAA benchmark.

Investment Portfolio Repositioning

For a discussion on the portfolio repositioning and risk reduction actions please see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Other Key Focuses of Management .

Investment Portfolio Structure

The Company s investment portfolio consists of fixed income securities, equities, alternative investments, private investments, derivatives and other investments and cash. These securities and investments are denominated in both U.S. dollar and foreign currencies. The Company s direct use of investment derivatives includes futures, forwards, swaps and option contracts that derive their value from underlying assets, indices, reference rates or a combination of these factors. When investment guidelines allow for the use of derivatives, these can generally only be used for the purpose of managing interest rate risk, foreign exchange rate risk, credit risk and replicating permitted investments, provided the use of such instruments is incorporated in the overall portfolio evaluation. The direct use of derivatives to economically leverage the portfolio outside of the stated guidelines is generally not permitted. Derivatives may also be used to add value to the investment portfolio where market inefficiencies are perceived to exist, to equitize cash holdings through the purchase of equity-indexed derivatives and to adjust the duration of a portfolio of fixed income securities as part of duration management activities for the P&C portfolio.

The Company s investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance. At December 31, 2009 and 2008, total investments, cash and cash equivalents, accrued investment income, and net receivable (payable) for investments sold (purchased), were $35.9 billion and $34.3 billion, respectively.

Functionally, the Company s investment portfolio is divided into two principle components:

1) *Property and casualty (P&C) investment portfolio*: The largest component is the P&C investment portfolio and its principal objective is to support the Company s insurance and reinsurance operations, the liabilities of which have some uncertainty as to the timing and/or amount. In addition, a smaller portion of the P&C investment portfolio supports corporate operations as well as run-off financial businesses (Structured Indemnity and Other Financial Lines), in which the liabilities have a greater level of certainty.

The principal asset classes in the P&C investment portfolio are summarized in the following table:

(U.S. dollars in thousands)	**Carrying Value 2009 (1)**	**Percent of Total**	**Carrying Value 2008 (1)**	**Percent of Total**
Cash and cash equivalents	$ 3,388,806	11.5 %	$ 3,973,249	13.9 %
Net receivable (payable) for investments sold (purchased)	54,167	0.2 %	185,977	0.6 %
Accrued investment income	214,023	0.7 %	241,717	0.8 %
Short-term investments	1,682,277	5.7 %	1,392,232	4.9 %
Fixed maturities, available for sale:				
U.S. Government and Government-Related/ Supported (2)	2,500,342	8.5 %	3,770,871	13.2 %
Corporate	6,337,182	21.5 %	6,235,085	21.7 %
Residential mortgage-backed	6,213,192	21.1 %	2,092,620	7.3 %

securities Agency				
Residential mortgage-backed securities Non-Agency	1,291,764	4.4 %	1,331,015	4.7 %
Commercial mortgage-backed securities	1,153,821	3.9 %	2,064,348	7.2 %
Collateralized debt obligations	698,561	2.4 %	638,779	2.2 %
Other asset-backed securities	756,901	2.6 %	2,008,039	7.0 %
U.S. states and political subdivisions of the states	911,672	3.1 %	468,770	1.6 %
Non-U.S. Sovereign Government, Supranational and Government-Related (2)	2,225,946	7.6 %	1,904,972	6.6 %
Total fixed maturities	$ 22,089,381	75.1 %	$ 20,514,499	71.5 %
Equity securities	17,779	0.1 %	361,819	1.3 %
Investments in affiliates (3)	1,185,604	4.0 %	1,552,789	5.4 %
Other investments	783,189	2.7 %	459,481	1.6 %
Total investments and cash and cash equivalents	$ 29,415,226	100.0 %	$ 28,681,763	100.0 %

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

(2) U.S. Government and Government-Related/Supported and Non U.S. Sovereign Government, Supranational and Government-Related include government-related securities with an amortized cost of $1,903.4 million and fair value of $1,909.1 million and U.S. Agencies with an amortized cost of $1,229.9 million and fair value of $1,261.8 million.

(3) There are two main categories within Investments in affiliates: 1) investment funds and 2) operating affiliates. Investment funds include $0.5 billion of alternative investment funds, and $0.3 billion of private investment funds at December 31, 2009, as compared to $0.9 billion and $0.3 billion respectively at December 31, 2008. Alternative investment funds are classified by the Company into four general style categories : (i) Event driven, which includes strategies that pursue merger arbitrage, distressed and special situations opportunities; (ii) Directional/tactical, which includes strategies that pursue long/short equity, managed futures and macro opportunities; (iii) Arbitrage, which includes strategies that pursue equity market neutral, fixed income arbitrage and convertible arbitrage opportunities; and (iv)

Multi-strategy, which includes strategies incorporating several aspects of the above.

Operating affiliates were valued at $0.4 billion at December 31, 2009 and $0.4 billion at December 31, 2008 respectively. Operating affiliates include investment and (re)insurance affiliates. As at December 31, 2009, the Company s allocation to investment and (re)insurance affiliates and investments in investment management companies securities was approximately 1.1% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 1.5% as at December 31, 2008. At December 31, 2009, the Company s investment in insurance affiliates included investments in ARX Holding Corporation and ITAÙ XL Seguros Corporativos S.A., representing operations in the U.S. homeowner s insurance and Brazilian commercial insurance markets, respectively. At December 31, 2009, the Company owned minority stakes in nine independent investment management companies. The Company seeks to achieve strong returns on capital while accessing the investment expertise of professionals to help manage portions of the Company s investment assets. The Company s active interactions with the managers of these investment firms provides it with an exchange of expertise that the Company believes

enhances its overall financial performance.

Where the Company maintains significant influence over the decisions of an operating affiliate, through board representation or through certain voting and/or consent rights, the Company s proportionate share of the income or loss from these companies is reported as net income from operating affiliates. The Company s existing managers manage or sponsor a broad range of investment products, providing institutional and high net worth investor s access to a wide array of asset classes and investment strategies. See Item 8, Note 9 to the Consolidated Financial Statements, Investments.

The investment strategy for the P&C investment portfolio is based on a SAA process, which establishes a portfolio asset allocation target (Benchmark) that is constructed to maximize enterprise value subject to business constraints and the risk tolerance of Management and approved by the Board of Directors Finance Committee (Finance Committee). The SAA process involves a stochastic DFA model of XL s P&C General Operations that includes financial conditions, reserve volatility and payout patterns, premium expense and loss ratio projections, liability correlations and sensitivities to economic variables.

The primary performance objective is capital preservation through managing the risk profile of the P&C investment portfolio to be within Management s risk tolerance envelope as reflected in the Benchmark. The second performance objective is for the constrained total return of the P&C investment portfolio to meet or exceed the total return of the Benchmark. The third performance objective is achieving the budget for Net Investment Income.

As part of the overall SAA process and framework the Company has developed and implemented a comprehensive limit framework which establishes limits and authorities that have been approved by Management and the Board of Directors. The objective of the limits is to control the range of exposures and the risk profile within which the Portfolio will be managed to ensure consistency with SAA and to tie the Portfolio to the Benchmark. The limits permit active or tactical deviations from the benchmark therefore allowing the Company to be underweight or overweight certain components of the Benchmark. The limit framework has been designed such that as the magnitude of these deviations increases or the resulting impact on the risk profile of the P&C investment portfolio reaches certain predetermined thresholds then additional levels of authority and approval are required, up to and including the Finance Committee. The limits are monitored by the Investment Group Compliance Team on a monthly basis with any new approvals being documented and reviewed in accordance with the authorities set out in the limit framework. On at least a quarterly basis a limit report and update, detailing the limits for which the Finance Committee is the approval party, is provided to the Finance Committee for their consideration, review and approval.

2) The second component of the investment portfolio is the Life investment portfolio, which was approximately $6.4 billion and $5.6 billion at December 31, 2009 and 2008, respectively. As at December 31, 2009, the Company s allocation to securities in the Life investment portfolio was approximately 18% of the total investment portfolio

(including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 16% as at December 31, 2008.

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

The principal asset classes in the Life investment portfolio are summarized in the following table:

(U.S. dollars in thousands)	**Carrying Value 2009 (1)**	**Percent of Total**	**Carrying Value 2008 (1)**	**Percent of Total**
Cash and cash equivalents	$ 254,891	4.0 %	$ 380,577	6.8 %
Net receivable (payable) for investments sold (purchased).	(6,529)	(0.1)%	(86,522)	(1.5)%
Accrued investment income	136,032	2.1 %	121,659	2.2 %
Short-term investments	95,083	1.5 %	74,091	1.3 %
Fixed maturities, available for sale:				
U.S. Government and Government-Related/Supported (2)	164,283	2.5 %	207,471	3.7 %
Corporate	3,461,818	53.7 %	3,053,518	54.4 %
Residential mortgage-backed securities Agency	15,309	0.2 %	7,335	0.1 %
Residential mortgage-backed securities Non-Agency	129,551	2.0 %	35,187	0.6 %
Commercial mortgage-backed securities	62,978	1.0 %	77,220	1.4 %
Other asset-backed securities	411,084	6.4 %	271,713	4.8 %
U.S. states and political subdivisions of the states	1,801	%		%
Non-U.S. Sovereign Government, Supranational and Government-Related (2)	1,175,827	18.2 %	1,469,425	26.2 %
Total fixed maturities	$ 5,422,651	84.0 %	$ 5,121,869	91.2 %
Fixed maturities, held to maturity	546,067	8.5 %		%
Total investments and cash and cash equivalents	$ 6,448,195	100.0 %	$ 5,611,674	100.0 %

(1) Carrying value represents the fair value for available for sale fixed maturities and amortized

cost for held to maturity securities.

(2) U.S. Government and Government-Related/Supported and Non U.S. Sovereign Government, Supranational and Government-Related include government-related securities with an amortized cost of $422.0 million and fair value of $417.5 million and U.S. Agencies with an amortized cost of $131.7 million and fair value of $133.2 million.

The investment strategy for the Life investment portfolio is based on an Asset-Liability Management (ALM) process, which establishes liability-based Benchmarks for each of the asset annuity transactions. A project is currently underway to expand the SAA process to include the Life investment portfolio.

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

Implementation of investment strategy

Although the Company s management within the Investment Group is responsible for implementation of the investment strategy, the day-to-day management of the investment portfolio is outsourced to investment management service providers in accordance with detailed investment guidelines provided and monitored by the Company. This allows the Company an active management of its investment portfolio with flexible access to top talents specializing in various investment products and markets. Investment management service providers are selected directly by the Company on the basis of various criteria including investment style, track record, performance, risk management capabilities, internal controls, operational risk, and diversification implications. Well-established, large institutional investment management service providers manage the vast majority of the Company s investment portfolio. Each investment management service provider may manage one or more portfolios, each of which is governed by a detailed set of investment guidelines, including overall objectives, risk limits, and diversification requirements that

fall within the Company s overall investment policies and guidelines, including but not limited to exposures to eligible securities, prohibited investments/transactions, credit quality and general concentrations limits.

Investment performance

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations for discussion of the Company s investment performance.

Investment portfolio credit ratings, duration and maturity profile

It is the Company s policy to operate the P&C and Life (aggregate) fixed income portfolio with a minimum weighted average credit rating of Aa3/AA . The aggregate credit rating is determined based on the weighted average rating of securities, where the average credit rating, where available, from Standard & Poor s (S&P), Moody s Investors Service (Moody s) and Fitch Ratings (Fitch) is allocated to each security. The weighted average credit rating of the aggregate fixed income portfolio was AA at December 31, 2009 and 2008.

The Company did not have an aggregate direct investment in a single corporate issuer, in excess of 5% of shareholders equity at December 31, 2009 or December 31, 2008, which excludes government-backed, government-sponsored enterprises, government-guaranteed paper, cash and cash equivalents, and asset and mortgage backed securities that were issued, sponsored or serviced by the parent.

The overall duration and currency denomination of the fixed income portfolio is managed relative to the SAA benchmark (for the P&C investment portfolio) and ALM benchmarks (for the Life investment portfolios), both of which incorporate matching currency and duration within a range relative to liabilities. Duration measures bond price volatility and is an indicator of the sensitivity of the price of a bond (or a portfolio of bonds) to changes in interest rates, assuming a parallel change in all global yield curves reflecting the percentage change in price for a 100 basis point change in yield. Management believes that the duration of the aggregate fixed income portfolio is the best single measure of interest rate risk for the aggregate fixed income portfolio and the table below summarizes the weighted average duration in years and currency of the main components of the aggregate fixed income portfolio at December 31, 2009 and 2008:

Aggregate Investment Portfolio Weighted Average Duration in Years	**December 31, 2009**	**December 31, 2008**
Fixed income portfolio by Liability Type:		
Total Property and Casualty and Structured Products	2.9	3.1
Life Operations	8.7	8.9
Total Fixed income portfolio	4.0	4.2
Fixed income portfolio by Liability Currency:		
U.S. Dollar	3.0	3.1
U.K. Sterling	7.6	7.6
Euro	5.6	6.3
Other	2.1	3.4
Aggregate Fixed income portfolio	4.0	4.2

The maturity profile of the aggregate fixed income portfolio is a function of the maturity profile of liabilities, the

expected operating cash flows of the Company and, to a lesser extent, the maturity profile of common fixed income benchmarks. For further information on the maturity profile of the fixed income portfolio see Item 8, Note 9 to the Consolidated Financial Statements, Investments.

Enterprise Risk Management (ERM)

Risk Management Framework

The Company faces strategic and operational risks related to, among others: underwriting activities, financial reporting, changing macro economic conditions, investment management risks, reserving estimates, changes in laws or regulation, information systems, business interruption and fraud. The Company s global property and casualty business, other businesses that are in run-off (such as its Life Operations) and its

investment portfolios each have their own set of risks (see Item 1A, Risk Factors, for a discussion of such risks). From time to time, these risks may exhibit greater levels of correlation than might be expected over the longer term due to the presence of, to a greater or lesser degree, some common risk drivers (internal or external to the Company) embedded in the Company s businesses that may manifest themselves simultaneously. An enterprise view of risk is required to identify and manage the consequences of these common risks and risk drivers on the Company s profitability, capital strength and liquidity.

The Company s ERM initiatives are led by the Chief Enterprise Risk Officer (CERO), who is a member of the Company s senior management team, and who reports to the Company s Chief Executive Officer. The CERO also acts as a liaison between the Company s Enterprise Risk Committee (see below) and the Special Committee on Enterprise Risk Management (see below) and the Board (or other of its committees) with respect to risk matters. All of the Company s employees are expected to assist in the appropriate and timely identification and management of risks and to enhance the quality and effectiveness of ERM.

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

Risk Governance

Risk Governance relates to the processes by which oversight and decision-making authorities with respect to risks are granted to individuals within the enterprise. The Company s governance framework establishes accountabilities for tasks and outcomes as well as escalation criteria. Governance processes are designed to ensure that transactions and activities, individually and in the aggregate, are carried out in accordance with the Company s risk policies, philosophies, appetites, limits and risk concentrations, and in a manner consistent with expectations of excellence of integrity, accountability and client service.

In order to enhance governance over its ERM activities, the Company established in 2009 the Special Committee on Enterprise Risk Management (the Special Committee) as a new Board Committee to oversee the Board s responsibilities relating to enterprise-wide management of the Company s key risks. The Special Committee reviews, among other things, the methodology for establishing the Company s risk capacity, the overall risk appetite for the Company, and policies for the establishment of risk limit frameworks and adherence to such limits and recommends risk limits to the full Board, based on management s recommendations and in consultation with the Finance Committee. The Special Committee also assesses the integrity and adequacy of the risk management function of the Company and evaluates the risk impact of any strategies under consideration to determine whether they are consistent with the Company s risk profile.

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

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

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

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

3. Asset Subcommittee: This subcommittee assists the ERC in its responsibilities in relation to governance and oversight of asset-related risks across the Company, including its Investment Portfolio. Among the activities under the responsibility of this subcommittee are (a) involvement in policy decisions on modeling and quantification of risk measurements; and (b) providing an interpretation

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

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

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

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

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

Risk Appetite Management

The Company believes that the management of risk appetite is fundamental to strong governance and necessary in order to produce, among other things, a high-quality earnings process. The Company s risk appetite framework establishes the risk preferences and risk agenda of the organization, which helps set a context for where risk/capital should be deployed in pursuit of value, and hence, from which returns should arise. The Company s risk appetite standards are integrated into its overall business and strategic planning process.

The Company s risk appetites, tolerances and related limits are designed to take account of and balance the expectations of the Company s stakeholders by helping to reinforce the Company s risk and return culture and by helping to set a context in which its risk preferences can be associated with decision-making across the organization.

The Company s risk appetite framework guides its strategies relating to, among other things, capital preservation, earnings volatility, net worth at risk, operational loss, liquidity standards, capital rating and capital structure. This framework also addresses the Company s tolerance to risks from material individual events (e.g., natural or man made catastrophes such as terrorism), the Company s investment portfolio, realistic disaster scenarios that cross multiple lines of business and from risks related to some or all of the above that may actualize concurrently, with the objective of preserving the Company s capital base. For example, in relation to catastrophe risk management, the Company considers the loss of capital due to a single large event and the loss of capital that would occur from multiple (but potentially smaller) events in any given year. The Company imposes a limit on catastrophe risk from any single loss in a given region/peril at a 1% exceedance probability. Tier 1 limits, which include natural catastrophes and other realistic disaster scenarios, are targeted at a level not to exceed 15% of beginning of year tangible shareholders equity, and Tier 2 limits, which include pandemic, longevity and country risk, are established at no more than half of Tier 1 limits. These target limits are established by a combination of commercially available models, internally developed probable maximum loss estimates and the judgment of management, as overseen by the Board.

Impact of ERM Processes

The Company believes that its ERM processes improve the quality and timeliness of strategic decisions, enhance the integration of strategic initiatives with the risks related to such initiatives and act as catalysts to improve risk awareness and informed action by and across the Company. The Company

believes that the integration of ERM with existing business processes and controls improves the quality of strategic decisions, optimizes the risk/reward characteristics of business strategies, and enhances the Company s overall risk management culture.

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

Ratings

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

A downgrade below A of the Company s principal insurance and reinsurance subsidiaries by either Standard & Poor s (S&P) or A.M. Best Company, Inc. (A.M. Best), which is two notches below the current S&P financial strength rating of A (Negative) and the A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger termination provisions in a significant amount of the Company s assumed reinsurance agreements and may potentially require the Company to return unearned premiums to cedants. In addition, due to collateral posting requirements under the Company s letter of credit and revolving credit facilities, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities (see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources, below). Specifically, a downgrade below A by A.M. Best would trigger such collateral requirements for the Company s two largest credit facilities. In certain limited instances, such downgrades may require the Company to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1A, Risk Factors, A downgrade or potential downgrade in our financial strength and credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations, and/or liquidity.

During 2009, there was no change in financial strength rating from any of the rating agencies, however, the following changes in outlook occurred:

In August 2009, Fitch Ratings (Fitch) revised the outlook of the financial strength rating of the Company s principal insurance and reinsurance subsidiaries to Negative from

Rating Watch Negative . Also in this announcement Fitch affirmed the financial strength rating as A . In its public announcement, Fitch noted that the removal of the Rating Watch Negative outlook was contingent upon the successful execution of the Company s plans to de-risk its investment portfolio, stabilization of investment performance and completion of its strategic review of life operations.

In December 2009, Moody s Investor Services, Inc. (Moody s) revised the outlook of the financial strength rating of the Company s principal insurance and reinsurance subsidiaries to Stable from Negative . Also in this announcement

Moody s affirmed the financial strength rating as A2 . In its public announcement, Moody s noted that the change in the outlook reflects the Company s improved capitalization and financial flexibility, as well as the stabilization of the business franchise.

In September 2009, A.M. Best affirmed the financial strength rating and outlook of the Company s principal insurance and reinsurance subsidiaries at A (Stable) and left the financial strength rating of XL Life Ltd unchanged at A- (Stable). In addition, in December 2009 S&P left the financial strength rating and outlook of the Company s operating insurance and reinsurance subsidiaries unchanged at A

(Negative).

The following table summarizes the financial strength and claims paying ratings, as noted above, from internationally recognized rating agencies in relation to the Company s principal insurance and reinsurance subsidiaries and pools as at February 26, 2010:

Rating agency	Agency s description of rating	Rating	Agency s rating definition	Ranking of Rating
A.M. Best	An opinion of an insurer s financial strength and ability to meet ongoing obligations to policyholders.	A (Stable)	Excellent ability to meet its ongoing obligations to policyholders.	The A grouping is the third highest ratings category out of fifteen. It is assigned to companies that have, in A.M. Best s opinion, an excellent ability to meet their ongoing obligations to policyholders.
S&P	A current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms.	A (Negative)	Strong financial security characteristics.	The A grouping is the third highest out of nine main ratings. Main ratings from AA to CCC are subdivided into three subcategories: + indicating the high end of the main rating; no modifier, indicating the mid range of the main rating; and indicating the lower end of the main rating.
Moody s	An opinion of the ability of insurance companies to repay punctually senior policyholder claims and obligations.	A2 (Stable)	Good financial security.	The A grouping is the third highest out of nine rating categories. Each rating category is subdivided into three subcategories. Moody s appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa . Numeric modifiers are used to refer to the ranking within a group with 1 being the highest and 3 being the lowest.
Fitch	An assessment of the financial strength of an insurance organization, and its capacity to meet senior obligations to policyholders and contract holders on a timely basis.	A (Negative)	Strong capacity to meet policyholder and contract obligations.	The A rating is the third highest out of twelve ratings categories. A rated insurers are viewed as possessing strong capacity to meet policyholder and contract obligations. + or may be appended to a rating to indicate the relative position of a credit within the rating category.

In addition, as at February 26, 2010, XL Capital Ltd currently had the following long-term debt ratings: bbb (Stable) from A.M. Best, BBB+ (Negative) from S&P, Baa2 (Stable) from Moody s and BBB+ (Negative) from Fitch.

The Company believes that the primary users of ratings include commercial and investment banks, policyholders, brokers, ceding companies and investors.

Tax Matters

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 25 to the Consolidated Financial Statements, Taxation.

Regulation

The Company s operations are subject to regulation and supervision in each of the jurisdictions where they are domiciled and licensed to conduct business. Generally, regulatory authorities can have broad supervisory and administrative powers over such matters as licenses, fitness of management, standards of

solvency, material transactions between affiliates, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of financial statements, reserves for unpaid losses and loss adjustment expenses, reinsurance, minimum capital and surplus requirements and/or risk based capital standards, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. In general, such regulation is for the protection of policyholders rather than shareholders.

Bermuda Operations

The Insurance Act 1978 of Bermuda and related regulations, as amended (the Act), regulates the Company s (re)insurance operating subsidiaries in Bermuda, and it provides that no person may carry on any insurance business in or from within Bermuda unless registered as an insurer by the Bermuda Monetary Authority (the BMA) under the Act. Insurance as well as reinsurance is regulated under the Act.

The Act imposes on Bermuda insurance companies, solvency and liquidity standards, certain restrictions on the declaration and payment of dividends and distributions, certain restrictions on the reduction of statutory capital, auditing and reporting requirements, and grants the Authority powers to supervise, investigate and intervene in the affairs of insurance companies. Significant requirements include the appointment of an independent auditor, the appointment of a loss reserve specialist and the filing of the Annual Statutory Financial Return with the BMA. The Supervisor of Insurance is the chief administrative officer under the Act.

In early July 2008, the Insurance Amendment Act of 2008 was passed, which introduced a number of changes to the Act, such as allowing the BMA to prescribe standards for an enhanced capital requirement and a capital and solvency return that insurers and reinsurers must comply with. The Bermuda Solvency Capital Requirement (BSCR) employs a standard mathematical model that can relate more accurately the risks taken on by (re)insurers to the capital that is dedicated to their business. (Re)insurers may adopt the BSCR model or, where an insurer or reinsurer believes that its own internal model better reflects the inherent risk of its business, an in-house model approved by the BMA. Class 4 (re)insurers, such as the Company, were required to implement the new capital requirements under the BSCR model beginning with fiscal years ending on or after December 31, 2008.

Under the Bermuda Companies Act 1981, as amended, a Bermuda company may not declare or pay a dividend or make a distribution out of contributed surplus if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the company s assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. For further information see Item 8, Note 26 to the Consolidated Financial Statements, Statutory Financial Data.

United States

Within the United States, the Company s insurance and reinsurance subsidiaries are subject to regulation and supervision by their respective states of incorporation and by other jurisdictions in which they do business. The methods of regulation vary, but in general have their source in statutes that delegate regulatory and supervisory powers to an insurance official. The regulation and supervision relate primarily to approval of policy forms and rates, the standards of solvency that must be met and maintained, including risk-based capital standards, material transactions between an insurer and its affiliates, the licensing of insurers, agents and brokers, restrictions on insurance policy terminations, the nature of and limitations on the amount of certain investments, limitations on the net amount of insurance of a single risk compared to the insurer s surplus, deposits of securities for the benefit of policyholders, methods of accounting, periodic examinations of the financial condition and market conduct of insurance companies, the form and content of reports of financial condition required to be filed, and reserves for unearned premiums, losses, expenses and other obligations. All transactions between or among the insurance and reinsurance company subsidiaries must be fair and equitable. In general, such regulation is for the protection of policyholders rather than shareholders.

Regulations generally require insurance and reinsurance companies to furnish information to their domestic state insurance department concerning activities that may materially affect the operations, management or financial condition and solvency of the company. Regulations vary from state to state but generally require that each primary insurance company obtain a license from the department of insurance of a state to conduct business in that state. A reinsurance company is not generally required to have an

insurance license to reinsure a U.S. ceding company from outside the U.S. However, for a U.S. ceding company to obtain financial statement credit for reinsurance ceded, the reinsurer must obtain an insurance license or accredited status from the cedant s state of domicile or another U.S. state with equivalent insurance regulation or must post collateral to support the liabilities ceded. In addition, regulations for reinsurers vary somewhat from primary insurers in that the form and rate of reinsurance contracts and the market conduct of reinsurers are not subject to regulator approval.

The Company s U.S. insurance and reinsurance subsidiaries are required to file detailed annual and, in most states, quarterly reports with state insurance regulators in each of the states in which they are licensed. Such annual and quarterly reports are required to be prepared on a calendar year basis. In addition, the U.S. insurance subsidiaries operations and accounts are subject to financial condition and market conduct examination at regular intervals by state regulators. Effective January 1, 2010, the Company s US insurance subsidiaries will also be required to comply with expanded state model audit laws which will require the filing of a Management s Report of Internal Control over Financial Reporting. The report will provide management s assertion that it has responsibility for establishing and maintaining a system of adequate internal controls over financial reporting, and will provide management s assessment that the system is effective. In addition, these new laws also expand the governance requirements of the insurance subsidiaries audit committees.

Statutory surplus is an important measure utilized by the regulators and rating agencies to assess the Company s U.S. insurance subsidiaries ability to support business operations and provide dividend capacity. The Company s U.S. insurance subsidiaries are subject to various state statutory and regulatory restrictions that limit the amount of dividends that may be paid, within any twelve month period, from earned surplus without prior approval from regulatory authorities. These restrictions differ by state, but are generally based on a calculation of the lesser of 10% of statutory surplus or 100% of adjusted net investment income to the extent that it has not previously been distributed.

The National Association of Insurance Commissioners (the NAIC) promulgated, and all states have adopted, Risk-Based Capital (RBC) standards for property and casualty companies and life insurance companies as a means of monitoring certain aspects affecting the overall financial condition of insurance companies. RBC is designed to measure the adequacy of an insurer s statutory surplus in relation to the risks inherent in its business. The NAIC s RBC Model Law provides for four incremental levels of regulatory attention for insurers whose surplus is below the calculated RBC target. These levels of attention range in severity from requiring the insurer to submit a plan for corrective action to actually placing the insurer under regulatory control. The Company s current RBC ratios for its U.S. subsidiaries are satisfactory and such ratios are not expected to result in any adverse regulatory action. The Company is not aware of any such actions relative to it.

While the federal government does not directly regulate the insurance business in the U.S. (other than for flood, nuclear and reinsurance of losses from terrorism), federal legislation and administrative policies can affect the insurance industry. The federal government has also undertaken initiatives in several areas that may impact the insurance industry including tort reform, corporate governance and the taxation of insurance companies. In addition, legislation has been introduced from time to time in recent years that, if enacted, could result in the federal government assuming a more direct role in the regulation of the insurance industry, primarily as respects federal licensing in lieu of state licensing.

International Operations

A substantial portion of the Company s property and casualty insurance business and a majority of its life reinsurance business is carried on in countries other than Bermuda and the U.S. The degree of regulation in foreign jurisdictions can vary. Generally, the Company s subsidiaries must satisfy local regulatory requirements. Licenses issued by foreign authorities to subsidiaries of the Company are subject to modification or revocation for cause by such authorities. The Company s subsidiaries could be prevented, for cause, from conducting business in certain of the jurisdictions where

they currently operate. While each country imposes licensing, solvency, auditing and financial reporting requirements, the type and extent of the requirements differ substantially. Key areas where countries may differ include: (i) the type of financial reports to be filed; (ii) a requirement to use local intermediaries; (iii) the amount of reinsurance permissible; (iv) the scope of any regulation of policy forms and rates; and (v) the type and frequency of regulatory examinations.

In addition to these requirements, the Company s foreign operations are also regulated in various jurisdictions with respect to currency, amount and type of security deposits, amount and type of reserves, amount and type of local investment and limitations on the share of profits to be returned to policyholders on participating policies. For further information see Item 8, Note 26 to the Consolidated Financial Statements, Statutory Financial Data.

European Union

Financial services including insurance, reinsurance, securities and Lloyd s in the United Kingdom are regulated by the Financial Services Authority (FSA). The FSA s Handbook of Rules and Guidance (the FSA Rules) covers all aspects of regulation including capital adequacy, financial and non-financial reporting and certain activities of U.K.-regulated firms. The Company s subsidiaries carrying out regulated activities in the U.K. comply with the FSA Rules. The Company s Lloyd s managing agency, its managed syndicates and its associated corporate capital vehicles are subject to additional Lloyd s requirements.

FSA regulations also impact the Company as controller (an FSA defined term) of its U.K.-regulated subsidiaries. Through the FSA s Approved Persons regime, certain employees and Directors are subject to regulation by the FSA of their fitness and certain employees are individually registered at Lloyd s.

The Company s network of offices in the European Union consists mainly of branches of U.K. as well as Irish (regulated by the Irish Financial Services Regulatory Authority IFSRA) companies that are principally regulated under European Directives from their home states, the U.K. and Ireland, rather than by each individual jurisdiction.

Employees

At December 31, 2009, the Company had 3,565 employees. At that date, 239 of the Company s employees were represented by workers councils and 410 of the Company s employees were subject to industry-wide collective bargaining agreements in several countries outside the United States.

Available Information

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

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

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

The Company adopted Corporate Governance Guidelines, as well as written charters for each of the Audit Committee, the Management Development and Compensation Committee, the Finance Committee, the Nominating, Governance and External Affairs Committee and the Special Committee on Enterprise Risk Management, as well as a Code of Ethics for Senior Financial Officers, a Code of Business Conduct & Ethics for employees and a related Compliance Program. Each of these documents is posted on the Company s web-site at *http://www.xlcapital.com*, and each is

available in print to any shareholder who requests it by writing to the Company at Investor Relations Department, XL Capital Ltd, XL House, One Bermudiana Road, Hamilton HM 08, Bermuda.

The Company intends to post on its website at http://www.xlcapital.com any amendment to, or waiver of, a provision of its Code of Business Conduct & Ethics that applies to its Chief Executive Officer, Chief Financial Officer and Controller or persons performing similar functions and that relates to any element of the code of ethics definition set forth in Item 406 of Regulation S-K of the Securities Act of 1933, as amended.

ITEM 1A. RISK FACTORS

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

Risks Related to the Company

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

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

A downgrade below A of our principal insurance and reinsurance subsidiaries by either Standard & Poor s (S&P) or A.M. Best Company (A.M. Best), which is two notches below the current S&P financial strength rating of A (Negative) and two notches below the current A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger termination provisions in a significant amount of our assumed reinsurance agreements and may potentially require us to return unearned premium to cedants. Whether a client would exercise its termination rights after such a downgrade would likely depend on, among other things, the reasons for the downgrade, the extent of the downgrade, prevailing market conditions, the degree of unexpired coverage, and the pricing and availability of replacement reinsurance coverage. Based on premium value, approximately 54% of our reinsurance contracts that incepted at January 1, 2009 contained provisions allowing clients to terminate those contracts upon a decline in our ratings. In the event of such a downgrade, we cannot predict whether or how many of our clients would actually exercise such termination rights or the extent to which any such terminations would have a material adverse effect on our financial condition, results of operations, cash flows or future prospects and could have a significant adverse effect on the market price for our securities. A downgrade could also result in a substantial loss of business for us as ceding companies and brokers that place such business may move to other insurers and reinsurers with higher ratings and the loss of key employees. In addition, due to collateral posting requirements under our letter of credit and revolving credit facility agreements, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities (see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources under Part II, Item 7 of this report). Specifically, a downgrade below A by A.M. Best would trigger such collateral requirements for the Company s two largest credit facilities. In certain limited instances, such downgrades may require us to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties.

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

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

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover our losses. To the extent that the funds generated by our ongoing operations are insufficient to fund future operating requirements and cover claim payments, or that our capital position is adversely impacted by mark-to-market changes on the investment portfolio, catastrophe events or otherwise, we may need to raise

additional funds through financings or curtail our growth and reduce our assets. As a result of the current severe economic conditions that persist in the capital markets, any future financing may not be available on terms that are favorable to us, if at all. In addition, any future equity financings could be dilutive to our existing shareholders or could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. Our inability to obtain adequate capital could have a material adverse effect on our business, financial condition and results of operations.

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

As a holding company with no direct operations or significant assets other than the capital stock of our subsidiaries, we rely on investment income, cash dividends, loans and other permitted payments from our subsidiaries to make principal and interest payments on our debt, to pay operating expenses and common and preferred shareholder dividends, to make capital investments in our subsidiaries and to pay certain of our other obligations that may arise from time to time. We expect future investment income, dividends and other permitted payments from these subsidiaries to be our principal source of funds to pay such expenses, preferred and common stock dividends and obligations. The payment of dividends to us by our insurance and reinsurance subsidiaries is regulated under the laws of various jurisdictions including Bermuda, the U.K., Ireland, and Switzerland and certain insurance statutes of various states in the United States in which our insurance and reinsurance subsidiaries are licensed to transact business and the other jurisdictions where we have regulated subsidiaries. For further information regarding regulatory restrictions governing the payment of dividends by the Company s significant property and casualty subsidiaries in Bermuda and the U.S., see Note 26 to the Consolidated Financial Statements Statutory Financial Data.

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

For a description of constraints under Irish law that may affect our ability to pay dividends as a result of the proposed redomestication, see the risk factor entitled If the redomestication becomes effective but our ordinary shareholders do not approve the Distributable Reserves Proposal, or if the Irish High Court does not approve the creation of distributable reserves in XL-Ireland, XL-Ireland will not be able to pay dividends or redeem or buy back shares following the Transaction unless and until we generate earnings after the Effective Time, and only to the extent of such earnings below.

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

Our assets are invested by a number of investment management service providers under the direction of the Company s management within the Investment Group in accordance, in general, with detailed investment guidelines set by us under the oversight of our Board of Directors, and established in accordance with our SAA framework for our P&C operations, and in accordance with asset-liability benchmarks for our Life operations. Although our investment policies stress diversification of risks, conservation of principal and liquidity, our investments are subject to market-wide risks, as noted below, and fluctuations, as well as to risks inherent in particular securities. We are exposed to significant capital markets risks related to changes in interest rates, credit spreads and defaults, market liquidity, equity prices and foreign currency exchange rates. If significant, continued market volatility, changes in interest rates, changes in credit spreads and defaults, a lack of pricing transparency, a reduction in market liquidity,

declines in equity prices, and the strengthening or weakening of foreign currencies against the U.S. dollar, individually or in tandem, this could have a material adverse effect on our consolidated results of operations, financial condition or cash flows through realized losses, impairments, and changes in unrealized positions. Levels of write-down or impairment are impacted by our assessment of the intent to sell securities which have declined in value as well as actual losses as a result of defaults or deterioration in

estimates of cash flows. We periodically review our investment portfolio structure and strategy. If, as a result of such review, we determine to reposition or realign portions of the investment portfolio and where we determine we will sell securities in an unrealized loss position, then we will incur an other than temporary impairment charge. Any such charge may have a material adverse effect on our results of operations and business.

For the year ended December 31, 2009, as a result of the prolonged and continued volatility and disruptions in the public debt and equity markets, we incurred realized and unrealized investment losses, as described in Management s Discussion and Analysis of Financial Condition and Results of Operations under Part II, Item 7 of this report. We continue to closely monitor current market conditions and evaluate the long term impact of this recent market volatility on all of our investment holdings. Depending on market conditions, we could incur additional realized and unrealized losses in future periods, which could have a material adverse effect on the Company s results of operations, financial condition and business.

Our exposure to interest rate risk relates primarily to the market price and cash flow variability associated with changes in interest rates. Our investment portfolio contains interest rate sensitive instruments, such as fixed income securities, which have been and may continue to be adversely affected by changes in interest rates from central bank monetary policies, domestic and international economic and political conditions and other factors beyond our control. A rise in interest rates would increase the net unrealized loss position of our investment portfolio, offset by our ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would decrease the net unrealized loss position of our investment portfolio, offset by lower rates of return on funds reinvested. We maintain a P&C investment portfolio with diversified maturities that has a weighted average duration that is determined in accordance with its SAA Benchmark based on a dynamic financial analysis of investment assets and liabilities, and maximizing the Company s enterprise value subject to accounting, regulatory, capital and risk tolerances. However, our estimates of the time and size of the liability cash flow profile may be inaccurate and we may be forced to liquidate investments prior to maturity at a loss in order to cover liabilities. We are exposed to interest rate risk relative to our liabilities.

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

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

The functional currencies of our principal insurance and reinsurance subsidiaries include the U.S. dollar, U.K. sterling, the Euro, the Swiss Franc, and the Canadian dollar. Exchange rate fluctuations relative to the functional currencies may materially impact our financial position, results of operations and cash

flows. Many of our non-U.S. subsidiaries maintain both assets and liabilities in currencies different than their functional currency, which exposes us to changes in currency exchange rates.

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

Certain of our investments may be illiquid and are in asset classes that have been experiencing significant market valuation fluctuations.

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

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

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

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

In response to the financial crises affecting the banking system and financial markets and going concern threats to financial institutions, there have been numerous regulatory and governmental actions. Within the United States, the Federal Reserve has taken action through reduced federal funds rates and expansion of acceptable collateral to provide additional liquidity. Fannie Mae and Freddie Mac have been placed under conservatorship along with having received capital injections and enhanced liquidity, and numerous financial institutions have received capital both in the form of emergency loans and the Emergency Economic Stabilization Act of 2008 which made available $700 billion of capital through direct Treasury equity investments, In early 2009, the American Recovery and Reinvestment Act of 2009 was enacted to provide further stimulus to institutions that have received or will receive financial assistance under the Troubled Asset Relief Program. Certain of our competitors, such as companies that engage in both life and property insurance lines of business, are participating, or may in the future, in some or all of these government programs.

There is the potential for initiatives, including but not limited to, cram-down legislation specifically relating to mortgage-backed securities. In certain residential mortgage backed securities (RMBS), the losses from such a cramdown may be shared across all tranches of the security on a prorated basis. The Company may absorb additional losses should any such investments that it holds become subject to any such cram-down provisions. At the present time, there is no clarity on how the rating agencies will react to such a development, and we may experience significant numbers of downgrades on our non-Agency RMBS holdings.

Within the United Kingdom and Euro-zone, similar actions including interest rate cuts and nationalization of certain financial institutions have been undertaken.

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

The purpose of these legislative and regulatory actions is to stabilize the U.S. and international banking systems, improve the flow of credit and foster an economic recovery. However, there can be no assurance as to the success of such actions or the effect that any such governmental actions or future regulatory initiatives may have on certain investment instruments in our investment portfolio, or on our competitive position, business and financial position.

Particularly within the Euro-zone, there is increasing market concern as to the potential default of government issuers. Should governments default on their obligations, there will be a negative impact on both the Company s direct holdings, as well as non-government issues held within the country of default.

If actual claims exceed our loss reserves, our financial results and cash flows could be adversely affected.

Our results of operations and financial condition depend upon our ability to assess accurately the potential losses associated with the risks that we insure and reinsure. We establish reserves for unpaid losses and loss adjustment expense (LAE) liabilities, which are estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. The process of establishing reserves for property and casualty claims can be complex and is subject to considerable variability as it requires the use of informed estimates and judgments. Actuarial estimates of unpaid loss and LAE liabilities are subject to potential errors of estimation, which could be significant, due to the fact that the ultimate disposition of claims incurred prior to the date of such estimation, whether reported or not, is subject to the outcome of events that have not yet occurred. Examples of these events include the accuracy of the factual information on which the estimates were based, especially as this develops, jury decisions, court interpretations, legislative changes, changes in the medical condition of claimants, public attitudes, and economic conditions such as inflation. Recent deficit spending by governments in the Company s major markets exposes the Company to heightened risk of inflation. Inflation in relation to medical costs, construction costs and tort issues in particular impact the property and casualty industry, however, broader market inflation also poses a risk to overall loss costs.

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

In relation to previously written financial guarantee business and related exposures, we establish reserves for losses and LAE on such business based on management s best estimate of the ultimate expected incurred losses. Establishment of such reserves requires the use and exercise of significant judgment by management, including with respect to estimates regarding the occurrence and amount of a loss on an insured or reinsured obligation. Estimates of losses may differ from actual results and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred. Examples of these events include changes in the level of interest rates, credit deterioration of insured and reinsured obligations, and changes in the value of specific assets supporting insured and reinsured obligations. In general, guarantees on previously written credit default swaps are exposed to the same risks as noted above, except in events of default by the guarantor. Credit default swaps, however, do not qualify for the financial guarantee scope exception under authoritative accounting guidance over derivative instruments and hedging activities, and, therefore are reported at fair value with changes in the fair value included in earnings. Fair value for such swaps are determined based on methodologies further described in Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates under Item II, Part 7 of this report. Any estimate of future costs is subject to the inherent limitation on

our ability to

predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and LAE will vary, perhaps materially, from any estimate.

We have an actuarial staff in each of our operating segments and a Chief Actuary who regularly evaluates the levels of loss reserves, taking into consideration factors that may impact the ultimate losses incurred. Any such evaluation could result in future changes in estimates of losses or reinsurance recoverable and would be reflected in our results of operations in the period in which the estimates are changed. Losses and LAE, to the extent that they exceed the applicable reserves, are charged to income as incurred. The reserve for unpaid losses and LAE represents the estimated ultimate losses and LAE less paid losses and LAE, and comprises case reserves and incurred but not reported loss reserves (IBNR). During the loss settlement period, which can span many years in duration for casualty business, additional facts regarding individual claims and trends often will become known and case reserves may be adjusted by allocation from IBNR without any change in the overall reserve. In addition, application of statistical and actuarial methods may require the adjustment of the overall reserves upward or downward from time to time. Accordingly, the ultimate settlement of losses may be significantly greater than or less than reported loss and loss expense reserves.

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

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

The occurrence of disasters could adversely affect our financial condition.

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

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

conditions, purchase catastrophe reinsurance and retrocessional protection, the occurrence of one or more major catastrophes in any given period could result in losses that exceed such reinsurance and retrocessional protection. This could have a material adverse

effect on our financial condition and results of operations and may result in substantial liquidation of investments, possibly at a loss, and outflows of cash as losses are paid.

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

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

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

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

Although the market price of our Class A ordinary shares gained 395% during fiscal 2009 as compared to the market price as at December 31, 2008, it has not fully recovered from the very significant decline in market price during fiscal 2008. A substantial portion of our annual compensation paid to our senior employees has, in recent years, been paid in the form of equity-based awards. In addition, we reduced the number of employees across nearly all of our locations in August 2008 as well as in the period between February and July 2009. The combination of these events could adversely affect our ability to hire, motivate and retain qualified employees.

In addition, certain of our senior executives who work in our Bermuda operations are not Bermudian and our success in such operations may depend in part on the continued services of key employees working in Bermuda. Under Bermuda law, non-Bermudians (other than spouses of Bermudians and holders of permanent resident certificates) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. A work permit may be granted or renewed by the Bermuda government for a specific period of time, upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian or holder of a permanent resident certificate) is available who meets the minimum standards reasonably required by an employer with respect to a certain position. The government of Bermuda places a six-year term limit on individuals with work permits, subject to certain exemptions for key employees. No assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term or that key employee status will be granted or revoked.

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

Our goodwill balance at December 31, 2009 was $826.0 million. When we acquire an entity, the excess of the purchase price over the net identifiable assets acquired is allocated to goodwill. We conduct impairment tests on our reported goodwill at least annually or more frequently if impairment indicators

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

Lawsuits, including putative class action lawsuits, have been filed against us by policyholders and security holders the ultimate outcome of which could have a material adverse effect on our consolidated financial condition, future operating results and/or liquidity

We are subject to lawsuits and arbitrations in the regular course of our business. See Item 3, Legal Proceedings . In addition, lawsuits have been filed against us as detailed in Item 8, Note 20(g) to the Consolidated Financial Statements, Commitments and Contingencies Claims and Other Litigation. We believe that we have substantial defenses to all outstanding litigation and intend to pursue our defenses vigorously, although an adverse resolution of one or more of these items could have a material adverse effect on our results of operations in a particular fiscal quarter or year.

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

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

In addition, through one or more of our subsidiaries, we entered into certain agreements with subsidiaries of Syncora pursuant to which we guaranteed certain obligations of Syncora Guarantee Re and Syncora Guarantee under specific agreements (the Guarantee Agreements). As at June 30, 2008, the total net par value outstanding of business written by subsidiaries of Syncora which fell under the Guarantee Agreements was approximately $60 billion. Pursuant to the terms of, and required conditions under, the Master Agreement, Syncora Guarantee Re s facultative quota share reinsurance agreement with Syncora Guarantee, and all individual risk cessions thereunder, and the Financial Security Master Facultative Agreement, and all individual risk cessions thereunder, were commuted, thereby rendering the Syncora Guarantee Re guarantee and Financial Security guarantee of no further force and effect.

Following the closing of the Master Agreement, Syncora and its applicable subsidiaries are required to use commercially reasonable efforts to commute the underlying financial guarantees that are the subject of the EIB

Guarantees. There can be no assurances that such commutation will ultimately occur and that our $920.5 million exposure (as of December 31, 2009) under the EIB Guarantees will be eliminated.

As further described in Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd. (Syncora) , while the New York Insurance Department (NYID) and the BMA approved the Master Agreement and related agreements and transactions, including the commutation of the agreements described above, and the Delaware Insurance Department (DID) approved the Master Agreement and the commutation of the Syncora Guarantee Re/Syncora Guarantee Quota Share, and although we believe the effect of the Master Agreement relieved us of all of our obligations under the Reinsurance Agreements and the Guarantee Agreements (other than as noted above with respect to the EIB Guarantee), no assurance can be given that the enforceability of the Master Agreement, the agreements relating thereto and the transactions contemplated thereunder will not be challenged, including under applicable fraudulent transfer laws (described in the following paragraph) and/or by asserting any number of other theories for recovery, including third-party beneficiary rights, or that other litigation will not be commenced against us as a result of the Master Agreement and such related agreements and transactions. We believe that we would have significant defenses to any such challenges and would vigorously defend against any such claims. However, we cannot assure you that any such claims would not be made or, that any such claims would not ultimately be successful.

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

intended to hinder, delay or defraud its creditors; or

received less than reasonably equivalent value or fair value consideration for such release; and either

was insolvent or rendered insolvent by reason of such occurrence; or

was engaged in a business or transaction for which its remaining assets

- constituted unreasonably small capital; or

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

Among other regulatory approvals obtained in connection with the Master Agreement, the NYID issued an approval letter to Syncora Guarantee under Section 1505 of the New York Insurance Law and the DID issued an approval letter to Syncora Guarantee Re under Section 5005(a) of the Delaware Insurance Code (effective upon Syncora Guarantee Re s redomestication to Delaware) (both of which require that the terms of a transaction between an issuer and one or more of its affiliates be fair and equitable) stating, in the case of NYID, that the terms of the Master Agreement and each of the commutations are fair and equitable to Syncora Guarantee and do not adversely affect policyholders of Syncora Guarantee and, in the case of the DID, stating that the terms of the Master Agreement and the commutation of the Syncora Guarantee Re/Syncora Guarantee Quota Share were fair and equitable to Syncora Guarantee. The BMA (the domiciliary regulator of Syncora Guarantee Re) also issued an approval letter approving the Master Agreement and each commutation to which Syncora Guarantee Re is a party, including the Syncora Guarantee Re/Syncora Guarantee Quota Share. There can be no assurance that a court would agree with our, the NYID s, the DID s, the BMA s or Syncora s conclusions, or as to what law or standard a court would ultimately apply in making any such determination or as to how such court would ultimately rule. Additionally, in the event of any liquidation or rehabilitation or similar proceeding of any insurance subsidiary of Syncora, there can be no assurance that any insurance regulator or regulators responsible for such proceedings, in their capacity as liquidator or rehabilitator, would respect the insurance regulatory approvals obtained in connection with the Master Agreement.

If any such challenge were successful, we could be required to honor our original obligations under the Reinsurance Agreements and Guarantee Agreements or be subject to other remedies. Any challenge could have a material adverse effect on the market price for our securities and on our business and, if successful, could also have a material adverse effect on our financial condition, results of operations and liquidity.

We may be unable to purchase reinsurance and, even if we are able to successfully purchase reinsurance, we are subject to the possibility of uncollectability. The impairment of other financial institutions also could adversely affect us.

We purchase reinsurance for our own account in order to mitigate the volatility that losses impose on our financial condition. Our clients purchase reinsurance from us to cover part of the risk originally written by them. Retrocessional reinsurance involves a reinsurer ceding to another reinsurer, the retrocessionaire, all or part of the reinsurance that the first reinsurer has assumed. Reinsurance, including retrocessional reinsurance, does not legally discharge the ceding company from its liability with respect to its obligations to its insureds or reinsureds. A reinsurer s or retrocessionaire s insolvency, inability or refusal to make timely payments under the terms of its agreements with us, therefore, could have a material adverse effect on us because we remain liable to our insureds and reinsureds. At December 31, 2009, we had approximately $4.0 billion of reinsurance recoverables and reinsurance balances receivable, net of reserves for uncollectible recoverables. For further information regarding our reinsurance exposure, see Management s Discussion and Analysis of Financial Condition and Results of Operations , under Part II, Item 7 of this report.

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

We also have exposure to counterparties in various industries, including banks, hedge funds and other investment vehicles, and in transactions in addition to reinsurance agreements, including derivative transactions. Many of these transactions expose us to credit risk in the event our counterparty fails to perform its obligations. Even if we are entitled to collateral when a counterparty defaults, such collateral may be illiquid or proceeds from such collateral when liquidated may not be sufficient to recover the full amount of the obligation. We also have exposure to financial institutions in the form of secured and unsecured debt instruments and equity securities.

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

Operational risk and losses can result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, or external events. Areas of operational risk can be heightened in discontinued or exited business as a result of reduced overall resource allocation and the loss of relevant knowledge and expertise by departing management. The Company has exited a number of businesses in recent years potentially increasing operational risk in such businesses.

We believe that our modeling, underwriting and information technology and application systems are critical to our business. Moreover, our information technology and application systems have been an important part of our underwriting process and our ability to compete successfully. We have also licensed certain systems and data from third parties. We cannot be certain that we will have access to these, or comparable, service providers, or that our information technology or application systems will continue to operate as intended. A major defect or failure in our internal controls or information technology and application systems could result in management distraction, harm to our reputation or increased expense.

In particular, we have outsourced the day-to-day management, custody and record-keeping of our investment portfolio to third-party managers and custodians that we believe to be reputable. A major defect in those investment managers investment management strategy, information and technology systems, internal controls or decision-making could result in management distraction and/or significant financial loss. A major defect in custodian internal controls or information and technology systems could result in management distraction or significant financial loss.

We believe appropriate controls and mitigation procedures are in place to prevent significant risk of defect in our internal controls, information technology, application systems, investment management and custody and record-keeping, but internal controls provide only reasonable, not absolute, assurance as to the absence of errors or irregularities and any ineffectiveness of such controls and procedures could have a material adverse effect on our business.

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

We market our insurance and reinsurance products worldwide primarily through insurance and reinsurance brokers. Marsh & McLennan Companies and AON Corporation and their respective subsidiaries each provided approximately 18% and 20% respectively, of our gross written premiums for property and casualty operations for the year ended December 31, 2009. Loss of all or a substantial portion of the business provided by one or more of these brokers could have a material adverse effect on our business.

Our reliance on brokers subjects us to credit risk.

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

Risks Related to the Insurance and Reinsurance Industries

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

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

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

The insurance and reinsurance industries are highly competitive. We compete on an international and regional basis with major U.S., Bermudian, European and other international insurers and reinsurers and with underwriting syndicates, some of which have greater financial and management resources and higher ratings than we do. We also compete with new companies that continue to be formed to enter the insurance and reinsurance markets. In addition, capital market participants have created alternative products that are intended to compete with reinsurance products. Increased competition could result in fewer submissions, lower premium rates and less favorable policy terms and conditions, which could reduce our margins.

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

In response to the tightening of supply in certain insurance and reinsurance markets resulting from, among other things, the September 11 event, the TRIP was created upon the enactment of the TRIA of 2002 to ensure the availability of commercial insurance coverage for certain terrorist acts in the U.S. This law established a federal assistance program through the end of 2005 to help the commercial property and casualty insurance industry cover claims related to future terrorism-related losses and required that coverage for terrorist acts be offered by insurers. TRIA was originally scheduled to expire at the end of 2005, but was extended in December 2005 for an additional two years. On December 26, 2007, President George W.

Bush approved the TRIPRA, extending TRIP through December 31, 2014 and also eliminating the distinction between foreign and domestic acts of terrorism.

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

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

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

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

- providing insurance and reinsurance capacity in markets and to consumers that we target, *e.g.*, the creation or expansion of a state or federal catastrophe funds such as those in Florida;

requiring our participation in industry pools and guarantee associations;

expanding the scope of coverage under existing policies;

regulating the terms of insurance and reinsurance policies; or

disproportionately benefiting the companies of one country over those of another.

Government intervention has recently taken the form of financial support of certain companies in our industry. Governmental support of individual competitors can lead to increased pricing pressure, a distortion of market dynamics, and ultimately prolonging the current period of soft market conditions. The insurance industry is also affected by political, judicial and legal developments that may create new and expanded theories of liability, which may result in unexpected claims frequency and severity and delays or cancellations of products and services by insureds, insurers and reinsurers which could adversely affect our business.

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

Consolidation in the insurance industry could adversely impact us.

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

Risks Related to Regulation

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

Our insurance and reinsurance subsidiaries operate in 24 countries around the world as well as in all 50 U.S. states. Our operations in each of these jurisdictions are subject to varying degrees of regulation and supervision. The laws and regulations of the jurisdictions in which our insurance and reinsurance subsidiaries are domiciled require, among other things, that these subsidiaries maintain minimum levels of statutory capital, surplus and liquidity, meet solvency standards, submit to periodic examinations of their financial condition and restrict payments of dividends and reductions of capital. Statutes, regulations and policies that our insurance and reinsurance subsidiaries are subject to may also restrict the ability of these subsidiaries to write insurance and reinsurance policies, make certain investments and distribute funds.

In recent years, the U.S. insurance regulatory framework has come under increased federal scrutiny. In addition, some state legislatures have considered or enacted laws that may alter or increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the National Association of Insurance Commissioners, which is the organization of insurance regulators from the 50 U.S. states, the District of Columbia and the four U.S. territories, as well as state insurance regulators regularly reexamine existing laws and regulations.

The European Commission is in the process of implementing changes to the prudential regulation of European insurers with a timeline to achieve full compliance by 2012. There remains significant uncertainty as to the impact of these efforts however such impacts could include the requirement for additional capital or security to be provided in certain jurisdictions which may impact profitability.

We may not be able to comply fully with, or obtain desired exemptions from, revised statutes, regulations and policies that govern the conduct of our business. Failure to comply with, or to obtain desired authorizations and/or exemptions under, any applicable laws could result in restrictions on our ability to do business or undertake activities that are regulated in one or more of the jurisdictions in which we operate and could subject us to fines and other sanctions. In addition, changes in the laws or regulations to which our insurance and reinsurance subsidiaries are subject, or in the interpretations thereof by enforcement or regulatory agencies, could have a material adverse effect on our business. In addition, if the proposed redomestication to Ireland discussed below is effected, we will be an Irish Company and will be required to comply with numerous Irish and European Union laws and regulations as from time to time in effect, which may have a material adverse effect on XL s financial condition and results of operations.

If our Bermuda operating subsidiaries become subject to insurance statutes and regulations in jurisdictions other than Bermuda or if there is a change in Bermuda law or regulations or the application of Bermuda law or regulations, there could be a significant and negative impact on our business.

XL Insurance (Bermuda) Ltd and XL Re Ltd, two of our wholly-owned operating subsidiaries, are registered Bermuda Class 4 insurers. As such, they are subject to regulation and supervision in Bermuda. Bermuda insurance statutes and the regulations and policies of the Bermuda Monetary Authority require XL Insurance (Bermuda) Ltd and XL Re Ltd to, among other things:

- maintain a minimum level of capital and surplus;
- maintain solvency margins and liquidity ratios;
- restrict dividends and distributions;
- obtain prior approval regarding the ownership and transfer of shares;

maintain a principal office and appoint and maintain a principal representative in Bermuda;

file an annual statutory financial return;

file annual audited financial statements in accordance with applicable GAAP or International Financial Reporting Standards;

file annual Bermuda Solvency Capital Requirement (BSCR), a risk-based capital adequacy model, and capital and solvency return;

allow for the performance of certain periodic examinations of XL Insurance (Bermuda) Ltd and XL

Re Ltd and
their
respective
financial
conditions.

These statutes and regulations may restrict our ability to write insurance and reinsurance policies, distribute funds and pursue our investment strategy.

In 2008, the Bermuda Monetary Authority (BMA) introduced new risk-based capital standards for insurance companies as a tool to assist the BMA both in measuring risk and in determining appropriate levels of capitalization. The amended Bermuda insurance statutes or regulations pursuant to the new risk-based supervisory approach required additional filings by insurers to be made to the BMA for the year ended December 31, 2009. The required statutory capital and surplus of our Bermuda-based operating subsidiaries increased under the BSCR. While our Bermuda-based operating subsidiaries currently have excess capital and surplus under these new requirements, there can be no assurance that such requirement or similar regulations, in their current form or as may be amended in the future, will not have a material adverse effect on our business, financial condition or results of operations.

The process of obtaining licenses is very time consuming and costly and XL Insurance (Bermuda) Ltd and XL Re Ltd may not be able to become licensed in jurisdictions other than Bermuda should we choose to do so. The modification of the conduct of our business that would result if we were required or chose to become licensed in certain jurisdictions could significantly and negatively affect our financial condition and results of operations. In addition, our inability to comply with insurance statutes and regulations could significantly and adversely affect our financial condition and results of operations by limiting our ability to conduct business as well as subjecting us to penalties and fines.

Because XL Insurance (Bermuda) Ltd and XL Re Ltd are Bermuda companies, they are subject to changes in Bermuda law and regulation that may have an adverse impact on our operations, including through the imposition of tax liability or increased regulatory supervision. In addition, XL Insurance (Bermuda) Ltd and XL Re Ltd will be exposed to any changes in the political environment in Bermuda, including, without limitation, changes as a result of the independence issues which have been discussed in Bermuda in recent years. While we cannot predict the future impact on our operations of changes in the laws and regulation to which we are or may become subject, any such changes could have a material adverse effect on our business, financial condition and results of operations.

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

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

Risks Related to Taxation

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

We take the position that neither we nor any of our non-U.S. insurance subsidiaries are engaged in a U.S. trade or business through a U.S. permanent establishment. Accordingly, we take the position that none

of our non-U.S. insurance subsidiaries should be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income). However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the United States, we cannot be certain that the U.S. Internal Revenue Service (the IRS) will not contend successfully that we or any of our non-U.S. insurance subsidiaries are engaged in a trade or business in the United States. If we or any of our non- U.S. insurance subsidiaries were considered to be engaged in a trade or business in the United States, any such entity could be subject to U.S. corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business, in which case our financial condition and results of operations could be materially adversely affected.

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

The tax treatment of non-U.S. companies and their U.S. and non-U.S. insurance subsidiaries has been the subject of Congressional discussion and legislative proposals. For example, one legislative proposal would impose additional limits on the deductibility of interest by foreign-owned U.S. corporations. Another legislative proposal would modify the standards which indicate when a non-U.S. corporation might be treated as a U.S. corporation for U.S. federal income tax purposes if it were considered to be primarily managed and controlled in the U.S. In addition, in 2009, legislation was proposed in the U.S. that would severely restrict the ability of a company to utilize affiliate reinsurance to manage its U.S. risks and capital position. In general, the legislation as proposed in the House of Representatives (a virtually identical Senate Finance Draft release was issued in 2008), would permanently disallow the deduction for premiums ceded to affiliates, to the extent the reinsurance exceeded industry aggregate levels of unrelated party reinsurance, calculated on a statutory line of business basis. The U.S. 2011 Fiscal Year Budget, issued on February 1, 2010, includes a provision that would disallow tax deductions for affiliate reinsurance premiums paid (net of ceding commissions) in excess of 50% of written premium, determined on a statutory line of business basis. If any of these proposals is enacted, the associated impact could have an adverse impact on us or our shareholders. It is possible that other legislative proposals could emerge in the future that could also have an adverse impact on us or our shareholders. We cannot assure you that future legislative action will not increase the amount of U.S. tax payable by us. If this happens, our financial condition and results of operations could be materially adversely affected.

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

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

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

The Organisation for Economic Co-operation and Development is considering measures that might change the manner in which we are taxed.

On July 17, 2008, the Organisation for Economic Co-operation and Development (the OECD) issued the final version of its Report on the Attribution of Profits to Permanent Establishments (the Report). The Report is the final report on the OECD s project to establish a broad consensus regarding the interpretation and practical application of Article 7 of the OECD Model Tax Convention on Income and on Capital (Article 7). Article 7 sets forth international tax principles for attributing profits to a permanent establishment and forms the basis of an extensive network of bilateral income tax treaties between OECD member countries and between many OECD member and non-member countries. Part IV of the Report addresses the attribution of profits to a permanent establishment of an enterprise that conducts insurance activities.

The OECD has undertaken to implement the conclusions of the Report in two phases. First, to provide improved certainty for the interpretation of existing treaties based on the current text of Article 7, the OECD has revised the commentary to the current version of Article 7 to take into account the conclusions of the Report that do not conflict with the existing interpretation of Article 7 reflected in the previous commentary. Second, to reflect the full conclusions of the Report, the OECD intends to issue a new version of Article 7 and related commentary to be used in the negotiation of new treaties and amendments to existing treaties. A discussion draft of the new Article 7 and related commentary was released on July 7, 2008. A revised draft was released on November 24, 2009 and the final version of this new Article 7 and related commentary is expected to be released at a later date. The final version of new Article 7 and related commentary might include provisions that could change the manner in which we are taxed.

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

Under certain circumstances, a U.S. person who owns 10% or more of the voting power of a foreign corporation that is a CFC (a foreign corporation in which 10% U.S. shareholders own more than 50% of the voting power of the foreign corporation or more than 25% of a foreign insurance company) for an uninterrupted period of 30 days or more during a taxable year must include in gross income for U.S. federal income tax purposes such 10% U.S. Shareholder s pro rata share of the CFC s subpart F income, even if the subpart F income is not distributed to such 10% U.S. Shareholder, if such 10% U.S. Shareholder owns (directly or indirectly through foreign entities) any shares of the foreign corporation on the last day of the corporation s taxable year. Subpart F income of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income) attributable to the insurance of risks situated outside the CFC s country of incorporation. Ownership of our equity security units by a U.S. person may cause such person to be treated for U.S. federal income tax purposes as the owner of our ordinary shares prior to the purchase contract settlement date. For purposes of interpreting the voting restrictions in our Articles of Association, we intend to treat the ordinary shares issuable upon settlement of a purchase contract underlying a unit as currently owned by the holder of that unit.

We believe that because of the dispersion of our share ownership, provisions in our organizational documents that limit voting power and other factors, no U.S. person or U.S. partnership that acquires our shares directly or indirectly through one or more foreign entities should be required to include its subpart F income in income under the CFC rules of the Internal Revenue Code of 1986, as amended (the Code). It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge, in which case an investor s investment could be materially adversely affected, if the investor is considered to own 10% or more of our shares.

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

If we are considered a PFIC for U.S. federal income tax purposes, a U.S. person who owns any of our shares will be subject to adverse tax consequences, including a greater tax liability than might otherwise apply and tax on amounts in advance of when tax would otherwise be imposed, in which case an investor s investment could be materially adversely affected. In addition, if we were considered a PFIC, upon the

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

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

If (i) the related person insurance income, which we refer to as RPII, of any one of our non-U.S. insurance subsidiaries were to equal or exceed 20% of that subsidiary s gross insurance income in any taxable year and (ii) U.S. persons were treated as owning 25% or more of the subsidiary s stock (by vote or value), a U.S. person who owns any ordinary shares, directly or indirectly, on the last day of such taxable year on which the 25% threshold is met would be required to include in its income for U.S. federal income tax purposes that person s ratable share of that subsidiary s RPII for the taxable year, determined as if that RPII were distributed proportionately only to U.S. holders at that date, regardless of whether that income is distributed. The amount of RPII earned by a subsidiary (generally premium and related investment income from the direct or indirect insurance or reinsurance of any direct or indirect U.S. holder of shares of that subsidiary or any person related to that holder) would depend on a number of factors, including the identity of persons directly or indirectly insured or reinsured by that subsidiary. Although we do not believe that the 20% threshold will be met in respect of any of our non-U.S. insurance subsidiaries, some of the factors that may affect the result in any period may be beyond our control. Consequently, we cannot provide absolute assurance that we will not exceed the RPII threshold in any taxable year.

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

We and our Bermuda insurance subsidiaries may become subject to taxes in Bermuda after March 28, 2016, which may have a material adverse effect on our financial condition, results of operations and your investment.

We and our Bermuda insurance subsidiaries have received from the Ministry of Finance in Bermuda exemptions from any Bermuda taxes that might be imposed on profits, income or any capital asset, gain or appreciation until March 28, 2016. The exemptions are subject to the proviso that they are not construed so as to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda (we and our Bermuda insurance subsidiaries are not so currently designated) and to prevent the application of any tax payable in accordance with the provisions of The Land Tax Act 1967 or otherwise payable in relation to the land leased to us and our Bermuda insurance subsidiaries. We, as a permit company under The Companies Act 1981 of Bermuda, have received similar exemptions, which are effective until March 28, 2016. Our Bermuda insurance subsidiaries are required to pay certain annual Bermuda government fees and certain business fees as an insurer under The Insurance Act 1978 of Bermuda. Currently there is no Bermuda withholding tax on dividends paid by our Bermuda insurance subsidiaries to us. Given the limited duration of the

Ministry of Finance s assurance, we cannot be certain that we or our Bermuda insurance

subsidiaries will not be subject to any Bermuda tax after March 28, 2016. Such taxation could have a material adverse effect on our financial condition, results of operations and the price of our ordinary shares.

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

Under current Cayman Islands law, we are not obligated to pay any taxes in the Cayman Islands on our income or gains. We have received an undertaking from the Governor-in-Council of the Cayman Islands pursuant to the provisions of the Tax Concessions Law, as amended, that until June 2, 2018, (i) no subsequently enacted law imposing any tax on profits, income, gains or appreciation shall apply to us and (ii) no such tax and no tax in the nature of an estate duty or an inheritance tax shall be payable on any of our ordinary shares, debentures or other obligations. Under current law, no tax will be payable on the transfer or other disposition of our ordinary shares. The Cayman Islands currently impose stamp duties on certain categories of documents; however, our current operations do not involve the payment of stamp duties in any material amount. The Cayman Islands also currently impose an annual corporate fee upon all exempted companies incorporated in the Cayman Islands. Given the limited duration of the undertaking from the Governor-in-Council of the Cayman Islands, we cannot be certain that we will not be subject to any Cayman Islands tax after June 2, 2018. Such taxation could have a material adverse effect on our financial condition, results of operations and your investment. As outlined in the Redomestication Proxy Statement it is proposed that XL Capital Ltd will become tax resident in Ireland with effect from July 1, 2010.

Risks Related to our Ordinary Shares

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

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

In particular, our Articles of Association provide that if, and for so long as, the votes conferred by the Controlled Shares (as defined below) of any person constitute 10% or more of the votes conferred by all our issued shares, the voting rights with respect to the Controlled Shares of such person shall be limited, in the aggregate, to a voting power equal to approximately (but slightly less than) 10%, pursuant to a formula set forth in the our Articles of Association. Controlled Shares of a person (as defined in our Articles of Association) include (1) all of our shares owned directly, indirectly or constructively by that person (within the meaning of Section 958 of the U.S. Internal Revenue Code of 1986, as amended), and (2) all of our shares owned directly, indirectly or constructively by that person or any group of which that person is a part, within the meaning of Section 13(d)(3) of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act). If the redomestication is completed, the Articles of Association of XL- Ireland will contain the same provision.

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

Our Articles of Association provide that our Board of Directors shall decline to register a transfer of shares if it appears to our Board of Directors, whether before or after such transfer, that the effect of such transfer would be to increase the number of Controlled Shares of any person to 10% or more of any class of our voting shares, of our total issued shares, or of the total voting power of our total issued shares. If the redomestication transaction is completed, the Articles of Association of XL- Ireland will contain the same provision.

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

Our Articles of Association contain provisions that may make it more difficult for shareholders to replace directors and could delay or prevent a change of control that a shareholder may consider favorable. These provisions include a staggered board of directors, limitations on the ability of shareholders to remove directors, limitations on voting rights and certain transfer restrictions on our ordinary shares. See Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities,

under Part II, Item 5 of this report. In addition, insurance regulations in certain jurisdictions may also delay or prevent a change of control or limit the ability of a shareholder to acquire in excess of specified amounts of our ordinary shares. For additional information regarding impediments to a change of control of the Company as a result of the proposed redomestication, see the risk factor entitled After the Redomestication, attempted takeovers of XL will be subject to the Irish Takeover Rules and subject to review by the Irish Takeover Panel below.

It may be difficult to enforce judgments against XL Capital Ltd or its directors and executive officers.

XL Capital Ltd is incorporated pursuant to the laws of the Cayman Islands and our principal executive offices are in Bermuda. Similarly, following the proposed redomestication, XL-Ireland will be incorporated pursuant to the laws of Ireland. In addition, certain of our directors and officers reside outside the United States and a substantial portion of our assets and the assets of such directors and officers are located outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon those persons or to recover on judgments of U.S. courts against us or our directors and officers, including judgments predicated upon civil liability provisions of U.S. federal securities laws. We have been advised by our Cayman counsel that there is doubt as to whether the courts of the Cayman Islands would enforce:

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

- original actions brought in the Cayman Islands against these

persons or XL Capital Ltd predicated solely upon U.S. federal securities laws.

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

In connection with the proposed redomestication, we have been advised that there is no treaty between Ireland and the United States providing for the reciprocal enforcement of foreign judgments. The following requirements must be met before the foreign judgment will be deemed to be enforceable in Ireland:

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

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

U.S. persons who own our ordinary shares may have more difficulty protecting their interests than U.S. persons who are shareholders of a U.S. corporation.

The law applicable to companies established in the Cayman Islands, under which we are governed, differs in certain material respects from laws generally applicable to U.S. corporations and their shareholders. These differences include the manner in which directors must disclose transactions in which they have an interest and their ability to vote notwithstanding a conflict of interest, the rights of shareholders to bring class action and derivative lawsuits and the scope of indemnification available to directors and officers. In addition, the law applicable to companies established in

Ireland, under which we have proposed to be governed pursuant to the redomestication, also differs in certain material respects from laws currently applicable to us as a Cayman Islands corporation. For additional information, see Risk Factors Related to the Redomestication below.

Risks Related to the Redomestication

For purposes of the following risk factors, Redomestication refers collectively to the proposed redomestication transaction. As described in greater detail in the Redomestication Proxy Statement,

whereby, if the necessary approval of our ordinary shareholders and the Grand Court of the Cayman Islands have been obtained and the other conditions have been satisfied, then the ordinary shares of XL-Cayman will be cancelled and shareholders will receive, on a one-for-one basis, new ordinary shares of XL- Ireland (the Ordinary Share Exchange), and, if the requisite approvals of the Series C and Series E preference shareholders and the Cayman Court have been obtained and the other applicable conditions satisfied, the cancellation of the preference shares of XL-Cayman in exchange for new preference shares of XL- Ireland on a one-for-one basis. Effective Time refers to the date on which the Ordinary Share Exchange becomes effective, which is currently expected to be July 1, 2010, but could be later.

Your rights as an ordinary shareholder will change as a result of the Ordinary Share Exchange due to differences between Irish law and Cayman Islands law.

Because of differences between Irish law and Cayman Islands law, we will become subject to new legal requirements if the Ordinary Share Exchange is consummated. In addition, your rights as an ordinary shareholder will change if the Ordinary Share Exchange is consummated.

Among other differences, under Irish law there will be additional limitations on the payment of dividends and the repurchase of shares, the authority of the Board to issue new shares must be approved by the ordinary shareholders at least every five years, and certain shareholder resolutions will require the affirmative vote of a higher or lower percentage of the ordinary shares voting. We discuss these and other differences in detail in the Redomestication Proxy Statement under the headings Description of XL Group plc Share Capital and Comparison of Rights of Shareholders and Powers of the Board of Directors.

Legislative or regulatory action could materially and adversely affect us after the Redomestication or eliminate or reduce some of the anticipated benefits of the Redomestication.

Our tax position could be adversely impacted by changes in tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof by the tax authorities in Ireland, the United States and other jurisdictions following the Transaction, and such changes may be more likely or become more likely in view of recent economic trends in such jurisdictions, particularly if such trends continue. For example, Ireland has suffered from the consequences of worldwide adverse economic conditions and the credit ratings on its debt have been downgraded. Such changes could cause a material and adverse change in our worldwide effective tax rate and we may have to take further action, at potentially significant expense, to seek to mitigate the effect of such changes. Any future amendments to the current income tax treaties between Ireland and other jurisdictions, including the United States, could subject us to increased taxation and/or potentially significant expense. We cannot assure you that the Transaction will eliminate the risk that these changes, if made, will apply to us.

The Transaction may not allow us to maintain a competitive worldwide effective corporate tax rate.

We believe the Transaction should permit us to maintain a competitive worldwide effective tax rate. However, we cannot provide any assurance as to what our worldwide effective tax rate will be after the Transaction because of, among other things, uncertainty regarding the amount of business activities in any particular jurisdiction in the future and the tax laws of such jurisdictions. Our actual worldwide effective tax rate may vary from our expectation and that variation may be material.

If the Redomestication becomes effective but our ordinary shareholders do not approve the Distributable Reserves Proposal, or if the Irish High Court does not approve the creation of distributable reserves in XL-Ireland, XL-Ireland will not be able to pay dividends or redeem or buy back shares following the Redomestication unless and until we generate earnings after the Effective Time, and only to the extent of such earnings.

Under Irish law, dividends must be paid and share redemptions and buy backs generally must be funded out of distributable reserves, which XL-Ireland will not have immediately following the Effective Time. If the Ordinary Share Exchange is approved, the XL-Cayman ordinary shareholders will also be asked at the extraordinary general meeting to approve the creation of distributable reserves in XL-Ireland (the Distributable Reserves Proposal). Creation of distributable reserves in XL-Ireland is being sought in connection with the Redomestication so that we would continue to be able to pay dividends and redeem and buy back shares, before we generate sufficient post-Redomestication earnings as would otherwise be necessary under Irish law.

If our ordinary shareholders approve such proposal and the Ordinary Share Exchange is consummated, we will seek to obtain the approval of the Irish High Court, as required for the creation of distributable reserves through a reduction of XL-Ireland s share premium account. Although we are not aware of any reason why the Irish High Court would not approve the creation of distributable reserves, the issuance of the required order is a matter for the discretion of the Irish High Court and there can be no assurance if or when such approval will be obtained. Even if the Irish High Court does approve the creation of distributable reserves, it may take substantially longer than we anticipate and the Irish High Court may not approve the reduction of the share premium account in the entire amount sought by XL.

Approval of the Distributable Reserves Proposal by our ordinary shareholders is not a condition to the scheme of arrangement becoming effective, but in the absence of Irish High Court approval of the creation of distributable reserves, we would not continue to be able to pay dividends and redeem and buy back shares before we generate sufficient post-Redomestication earnings, as would otherwise be necessary under Irish law. Further, we are seeking the approval of at least 75% of all ordinary shares present and voting, in person or by proxy, to increase the likelihood of obtaining Irish High Court approval with respect to the creation of distributable reserves in XL-Ireland because such higher approval threshold would be required if the vote on the Distributable Reserves Proposal were being conducted under Irish law.

If the XL-Cayman ordinary shareholders approve the proposal to effect the Ordinary Share Exchange but do not approve the Distributable Reserves Proposal and the Redomestication is consummated, or if the Irish High Court does not approve the creation of distributable reserves, XL-Ireland will not have sufficient distributable reserves to pay dividends or to buy back or redeem shares unless and until we generate earnings after the Effective Time, and only to the extent of such earnings. In addition, the Board may determine not to proceed with the Redomestication for any reason, including because the Distributable Reserves Proposal is not approved or is approved by holders of fewer than 75% of all ordinary shares present and voting, in person or by proxy.

As a result of different shareholder voting requirements in Ireland relative to the Cayman Islands, we will have less flexibility with respect to certain aspects of capital management.

Under Cayman Islands law, our Board may issue, without shareholder approval, any shares authorized in our memorandum of association that are not already issued. Irish law allows shareholders to authorize a Board of Directors to subsequently issue shares without shareholder approval, but this authorization must be renewed after five years. Additionally, subject to specified exceptions, Irish law grants statutory pre-emption rights to existing ordinary shareholders to subscribe for new issuances of shares for cash, but allows such shareholders to authorize the waiver of such statutory pre-emption rights for five years. Prior to the Effective Time, the articles of association of XL-Ireland will provide such authority to the Board of Directors of XL-Ireland to issue shares without further shareholder approval and a waiver of these statutory pre-emption rights for a period of five years in each such case. These authorizations expire after five years, unless renewed by XL-Ireland s shareholders, and we can provide no assurance that these authorizations and waivers will always be renewed, which could limit our ability to issue equity in the future. While we do not believe that the differences between Cayman Islands law and Irish law relating to our capital management will have a material and adverse effect on us, situations may arise where the flexibility we now have in the Cayman Islands would have provided benefits to our shareholders that will not be available in Ireland.

As a result of different shareholder voting requirements in Ireland relative to the Cayman Islands, we will have less flexibility with respect to our ability to amend our constituent documents and to take other actions requiring a special resolution of our shareholders than we now have.

Under Cayman Islands law and our current articles of association, our memorandum and articles of association may be amended by a special resolution of our ordinary shareholders, which requires approval by not less than 2/3 of the votes cast by XL-Cayman s ordinary shareholders at a general meeting of such shareholders at which holders of at least 2/3 of all ordinary shares are present. Under Irish law and the XL-Ireland articles of association, the special resolution required to amend XL-Ireland s memorandum and articles of association will require the approval of not less than 75%

of the votes cast by XL-Ireland s ordinary shareholders at a general meeting of such shareholders at which holders of at least 2/3 of all XL-Ireland ordinary shares are present. Additional corporate actions that require approval by special resolution in both the Cayman Islands and Ireland include, but are not limited to, approval of a name change,

approval of a reduction in share capital and approval of the winding-up of a company. As a result of the increased approval requirement for passage of a special resolution in Ireland, situations may arise where the flexibility we now have in the Cayman Islands would have provided benefits to our shareholders that will not be available in Ireland.

We may be required to pay additional amounts in respect of dividends on our preference shares or interest payments on our debt after completion of the Redomestication.

After the Redomestication, XL-Ireland and/or its subsidiaries may have an obligation to pay additional amounts to our preference shareholders and holders of our debt under certain circumstances. Specifically, under Irish tax law, and subject to exceptions, dividends and interest are generally subject to a withholding tax (currently at 20%), which could trigger an obligation to pay additional amounts with respect to our preference shares and debt obligations. We do not expect such obligations to be material, as we believe our current preference shareholders and the holders of our debt generally should qualify for dividend and interest withholding tax exceptions, respectively. However, we are unable to predict the costs of such obligations or exclude as a possibility that the obligations to pay additional amounts could be material at some time in the future.

If the Cayman Court does not sanction the scheme of arrangement, XL-Cayman will not have the ability to effect the Redomestication.

We cannot proceed with the Transaction unless the Cayman Court sanctions the scheme of arrangement after conducting a hearing. Assuming that the scheme of arrangement meetings are conducted in accordance with the Cayman Court s order and that the ordinary shareholders approve the proposal to effect the Ordinary Share Exchange by the majority required by the Cayman Companies Law, we are not aware of any reason why the Cayman Court would not sanction the scheme of arrangement. Nevertheless, the Cayman Court s sanction is a matter for its discretion and there can be no assurance if or when such sanction will be obtained.

If the Cayman Court does not sanction the scheme of arrangement, XL-Cayman will be unable to effect the Redomestication, even if the requisite ordinary shareholders have approved the scheme of arrangement. In addition, the Cayman Court may impose such conditions, modifications or amendments as it deems appropriate in relation to the scheme of arrangement, but may not impose any material changes without the joint consent of XL-Cayman and XL-Ireland. If such conditions, modifications or amendments are imposed, XL will be unable to effect the Redomestication without amending the scheme of arrangement, which, depending on the nature of such conditions, modifications or amendments, might require new shareholder approvals.

After the Redomestication, attempted takeovers of XL will be subject to the Irish Takeover Rules and subject to review by the Irish Takeover Panel.

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

The Irish Takeover Rules also could discourage an investor from acquiring 30% or more of the outstanding ordinary shares of XL-Ireland unless such investor were prepared to make a bid to acquire all outstanding ordinary shares. Further, it could be more difficult for XL-Ireland to obtain shareholder approval for a merger or negotiated transaction after the Redomestication because the shareholder approval requirements for certain types of transactions differ, and in some cases are greater, under Irish law than under Cayman Islands law.

After the Redomestication, a future transfer of your XL-Ireland ordinary shares, other than one effected by means of the transfer of book entry interests in DTC, may be subject to Irish stamp duty.

Transfers of XL-Ireland ordinary shares effected by means of the transfer of book entry interests in DTC will not be subject to Irish stamp duty. It is anticipated that the majority of XL-Ireland ordinary

shares will be traded through DTC, either directly or through brokers who hold such ordinary shares on behalf of customers through DTC. However, if you hold your XL-Ireland ordinary shares directly rather than beneficially through DTC (or through a broker that holds your ordinary shares through DTC), any transfer of your XL-Ireland ordinary shares could be subject to Irish stamp duty (currently at the rate of 1% of the higher of the price paid or the market value of the ordinary shares acquired). Payment of Irish stamp duty is generally a legal obligation of the transferee. The potential for stamp duty could adversely affect the price of our ordinary shares.

After the Redomestication, dividends you receive may be subject to Irish dividend withholding tax and Irish income tax.

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

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

The Redomestication will result in additional direct and indirect costs, even if it is not consummated.

We will incur additional costs and expenses in connection with and as a result of the Redomestication. These costs and expenses include professional fees to comply with Irish corporate and tax laws and financial reporting requirements (including the need to provide annual financial statements complying with Irish requirements commencing with respect to XL-Ireland s 2014 fiscal year), costs and expenses incurred in connection with holding a majority of the meetings of the XL-Ireland Board of Directors and certain executive management meetings in Ireland, as well as any additional costs we may incur going forward as a result of our new corporate structure. In addition, we have incurred and expect to incur further legal fees, accounting fees, filing fees, mailing expenses and financial printing expenses in connection with the Redomestication, even if the proposal to effect the Ordinary Share Exchange is not approved or the Redomestication is not consummated.

The market for the XL-Ireland ordinary shares may differ from the market for the XL-Cayman ordinary shares.

We will continue to list our ordinary shares on the NYSE under the symbol XL , the same trading symbol as the XL-Cayman ordinary shares. The market price, trading volume or volatility of the XL-Ireland ordinary shares could be different from those of the XL-Cayman ordinary shares.

Based on the recent experience of other companies, the change in our place of incorporation will likely result in XL being removed from the S&P 500 index and certain other indices, which could result in a negative impact on our ordinary share price if index-modeled shareholders are required to sell our ordinary shares.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

In July 2003, the Company acquired new offices at 70 Gracechurch Street, London, which have become the Company s new London headquarters. The acquisition was made through a purchase, sale and leaseback transaction. The move to the new offices was completed in 2004 and consolidated the Company s London businesses in one location. The capital lease asset and liability associated with this transaction totaled $118.0 million at December 31, 2009.

The majority of all other office facilities throughout the world that are occupied by the Company and its subsidiaries are leased.

Total rent expense for the years ended December 31, 2009, 2008 and 2007 was $34.4 million, $35.4 million and $34.5 million, respectively. See Item 8, Note 20(d) to the Consolidated Financial Statements, Commitments and Contingencies Properties, for discussion of the Company s lease commitments for real property.

ITEM 3. LEGAL PROCEEDINGS

In November 2006, a subsidiary of the Company received a grand jury subpoena from the Antitrust Division of the U.S. Department of Justice (DOJ) and a subpoena from the SEC, both of which sought documents in connection with an investigation into the municipal GICs market and related products. In June 2008, subsidiaries of the Company also received a subpoena from the Connecticut Attorney General and an Antitrust Civil Investigative Demand from the Office of the Florida Attorney General in connection with a coordinated multi-state Attorneys General investigation into the matters referenced in the DOJ and SEC subpoenas. The Company is fully cooperating with these investigations.

Commencing in March 2008, the Company and two of its subsidiaries were named, along with approximately 20 other providers and insurers of municipal Guaranteed Investment Contracts and similar derivative products in the U.S. (collectively Municipal Derivatives) as well as fourteen brokers of such products, in several purported federal antitrust class actions. The Judicial Panel on Multidistrict Litigation ordered that these be consolidated for pretrial purposes and assigned them to the Southern District of New York. The consolidated amended complaint filed in August 2008 alleges that there was a conspiracy among the defendants during the period from January 1, 1992 to the present to rig bids and otherwise unlawfully decrease the yield for Municipal Derivative products. The purported class of plaintiffs consists of purchasers of Municipal Derivatives. On October 21, 2008 most of the defendants filed motions to dismiss the consolidated amended complaint. The District Judge granted the motions by order dated April 29, 2009, but allowed plaintiffs leave to file a second amended complaint within 20 days of the order. Plaintiffs filed a Second Consolidated Amended Class Action Complaint on June 18, 2009, but did not include the Company or any subsidiaries as a defendant. In addition, the Company and three subsidiaries of the Company were named in eleven individual (i.e., non-class) actions filed by various municipalities or other local government bodies in California state courts. The Defendants removed those cases to federal court and the cases were then transferred to the Southern

District of New York by the Judicial Panel on Multidistrict Litigation. On February 9, 2010, the Company and subsidiaries filed a motion to dismiss all eleven actions and intends to vigorously defend them.

In August 2005, plaintiffs in a proposed class action (the Class Action) that was consolidated into a multidistrict litigation in the United States District Court for the District of New Jersey, captioned In re Brokerage Antitrust Litigation, MDL No. 1663, Civil Action No. 04-5184 (the MDL), filed a consolidated amended complaint (the Amended Complaint), which named as new defendants approximately 30 entities, including Greenwich Insurance Company, Indian Harbor Insurance Company and XL Capital Ltd. In the MDL, the Class Action plaintiffs asserted various claims purportedly on behalf of a class of commercial insureds against approximately 113 insurance companies and insurance brokers through which the named plaintiffs allegedly purchased insurance. The Amended Complaint alleged that the defendant insurance companies and insurance brokers conspired to manipulate bidding practices for insurance policies in certain

insurance lines and failed to disclose certain commission arrangements and asserted statutory claims under the Sherman Act, various state antitrust laws and the Racketeer Influenced and Corrupt Organizations Act (RICO), as well as common law claims alleging breach of fiduciary duty, aiding and abetting a breach of fiduciary duty and unjust enrichment. By Opinion and Order dated August 31, 2007, the Court dismissed the Sherman Act claims with prejudice and, by Opinion and Order dated September 28, 2007, the Court dismissed the RICO claims with prejudice. The plaintiffs then appealed both Orders to the U.S. Court of Appeals for the Third Circuit. Oral argument before the appellate court was held on April 21, 2009. In accordance with the Third Circuit s April 23, 2009 directive, the parties submitted on May 13, 2009 their respective supplemental letter briefs addressing a question raised by the Court. The appeal remains pending.

Various XL entities have been named as defendants in three of the many tag-along actions that have been consolidated into the MDL for pretrial purposes. The complaints in these tag-along actions make allegations similar to those made in the Amended Complaint but do not purport to be class actions. On April 4, 2006, a tag-along complaint was filed in the U.S. District Court for the Northern District of Georgia on behalf of New Cingular Wireless Headquarters LLC and several other corporations against approximately 100 defendants, including Greenwich Insurance Company, XL Specialty Insurance Company, XL Insurance America, Inc., XL Insurance Company Limited, Lloyd s syndicates 861, 588 and 1209 and XL Capital Ltd.. On or about May 21, 2007, a tag-along complaint was filed in the U.S. District Court for the District of New Jersey on behalf of Henley Management Company, Big Bear Properties, Inc., Northbrook Properties, Inc., RCK Properties, Inc., Kitchens, Inc., Aberfeldy LP and Payroll and Insurance Group, Inc. against multiple defendants, including XL Winterthur International. On October 12, 2007, a complaint in a third tag-along action was filed in the U.S. District Court for the Northern District of Georgia by Sears, Roebuck & Co., Sears Holdings Corporation, Kmart Corporation and Lands End Inc. against many named defendants including X.L. America, Inc., XL Insurance America, Inc., XL Specialty Insurance Company and XL Insurance (Bermuda) Ltd. The three tag-along actions are currently stayed. The Judge presiding over the MDL has set a conference for March 2, 2010 to review whether he should suggest to the Judicial Panel on Multidistrict Litigation that the remaining tag-along actions be remanded to the respective courts in which they were originally filed.

Three purported class actions on behalf of shareholders of Syncora have been filed in the Southern District of New York against the Company and one of its subsidiaries (collectively XL), Syncora, four Syncora officers, and various underwriters of Syncora securities. The Judge ordered that these be consolidated. The consolidated amended complaint, filed in August 2008, alleges violations of the Securities Act of 1933 arising out of the secondary public offering of Syncora common shares held by XL on June 6, 2007 and sales/exchanges by Syncora of certain preferred shares as well as under the Securities Exchange Act of 1934 arising out of trading in Syncora securities during the asserted class period of March 15, 2007 to March 17, 2008. The principal allegations are that Syncora failed to appropriately and timely disclose its exposures under certain derivative contracts and insurance of tranches of structured securities. XL is named as a party that controlled Syncora during the relevant time period. In October 2008, XL and other defendants filed motions to dismiss the consolidated amended complaint, which motions have been fully briefed. The Company intends to vigorously defend these actions.

In connection with the secondary offering of the Company s Syncora shares, the Company and Syncora each agreed to indemnify the several underwriters of that offering against certain liabilities, including liabilities under the Securities Act of 1933 for payment of legal fees and expenses, settlements and judgments incurred with respect to litigation such as this. The Company and Syncora have agreed to each bear 50% of this indemnity obligation.

The Company is subject to litigation and arbitration in the normal course of its business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company s loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to litigation relating to insurance and reinsurance claims, the Company and its subsidiaries are subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to

claims on insurance or reinsurance policies. This category of business litigation typically involves, amongst other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes or

disputes arising from business ventures. The status of these legal actions is actively monitored by management. The Company believes that the expected ultimate outcome of all outstanding litigation and arbitration will not have a material adverse effect on its consolidated financial condition, operating results and/or cash flow, although an adverse resolution of one or more of these items could have a material adverse effect on the Company s results of operations in a particular fiscal quarter or year.

Legal actions are subject to inherent uncertainties, and future events could change management s assessment of the probability or estimated amount of potential losses from pending or threatened legal actions. For further information in relation to legal proceedings, see Item 8, Note 20 (g) to the Consolidated Financial Statements, Commitments and Contingencies Claims and Other Litigation.

ITEM 4. RESERVED

Executive Officers of the Company

The table below sets forth the names, ages and titles of the persons who were the executive officers of the Company at February 26, 2010:

Name	Age	Position
Michael S. McGavick	52	Chief Executive Officer and Director
Simon Rich	46	Senior Vice President and Interim Chief Financial Officer (1)
James H. Veghte	53	Executive Vice President and Chief Executive of Reinsurance Operations
David B. Duclos	52	Executive Vice President and Chief Executive of Insurance Operations
Sarah E. Street	47	Executive Vice President and Chief Investment Officer
Kirstin Romann Gould	43	Executive Vice President, General Counsel and Secretary
Susan L. Cross	49	Executive Vice President and Global Chief Actuary
Jacob D. Rosengarten	54	Executive Vice President and Chief Enterprise Risk Officer
Elizabeth L. Reeves	51	Executive Vice President, Chief Human Resources Officer
W. Myron Hendry	61	Executive Vice President and Chief Platform Officer

(1) During 2009, the Company and its Executive Vice President and Chief Financial Officer, Mr. Brian

Nocco, agreed that Mr. Nocco would leave the Company effective December 31, 2009. The Company appointed Simon Rich, Controller since March 2005, to the position of Interim Chief Financial Officer effective January 1, 2010.

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

Simon Rich was appointed Interim Chief Financial Officer on January 1, 2010 in addition to his existing role of Senior Vice President and Controller of the Company, a position Mr. Rich has held since the first quarter of 2005. Prior to that Mr Rich held positions as the Finance Director of XL London Market, the Company s Lloyd s operations, Chief Financial Officer for the Company s Global Risk business and Head of Management Information for the Insurance Segment. Before joining XL in 2001, Mr. Rich worked with the financial services practice of PricewaterhouseCoopers in London.

James H. Veghte was appointed Executive Vice President, Chief Executive of Reinsurance Operations in January 2006. Mr. Veghte has served as the Chief Executive Officer of XL Reinsurance America Inc. (XLRA) since 2004, having previously served as Chief Operating Officer of the Company s reinsurance operations and President, Chief Operating Officer & Chief Underwriting Officer of XL Re Ltd. Additional previously held roles with the Company include President of XL Re Latin America Ltd., Chief Operating Officer of Le Mans Re (now the French branch of XL Re Europe Ltd.), General Manager of XL Re Ltd s London branch and Executive Vice President and Underwriter of XL Mid Ocean Reinsurance Ltd in

Bermuda. Prior to joining XL, Mr. Veghte was Senior Vice President and Chief Underwriting Officer of Winterthur Reinsurance Corp of America.

David B. Duclos was appointed Executive Vice President, Chief Executive of Insurance Operations in April 2008. From 2006 to his appointment in April 2008, Mr. Duclos was the Chief Operating Officer of the Company s Insurance Operations and was responsible for product line underwriting, regional management and sales, ceded reinsurance and risk management. From 2004 to 2006, Mr. Duclos served as Executive Vice President of global specialty lines within the Company s Insurance Operations and in 2003, upon joining the Company, he served as Senior Vice President responsible for U.S. program operations. Prior to joining the Company, Mr. Duclos worked for more than three years at Kemper Insurance Company in various senior level positions. Mr. Duclos began his career with CIGNA Corporation where he spent 21 years in various regional and national management roles in the field and home office.

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

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

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

Jacob D. Rosengarten joined the Company s senior leadership team and was appointed Executive Vice President, Chief Enterprise Risk Officer in September 2008. Prior to joining the Company, Mr. Rosengarten served as Managing Director of Risk Management and Analytics for Goldman Sachs Asset Management (GSAM) from 1998 to 2008. From 1993 to 1998, Mr. Rosengarten served as Director of Risk and Quantitative Analysis at Commodities Corporation (now GSAM s Hedge Fund Strategy Unit).

Elizabeth L. Reeves was appointed to the Company s senior leadership team in June 2009, serving as Executive Vice President, Chief Human Resources Officer, where she is responsible for global compensation, employee benefits, employee relations, recruiting, learning, organizational development, performance management, talent development, succession planning, HR information systems and Payroll. Prior to joining the Company, from August 2008 to May 2009 Ms. Reeves served as Senior Vice President and Chief Human Resources Officer at Liz Claiborne, Incorporated. Prior to that, from January 2005 to May 2008 Ms. Reeves served as Senior Vice President of Human Resources at Lincoln Financial Group.

W. Myron Hendry joined the Company s senior leadership team and was appointed Executive Vice President, Chief Platform Officer in December 2009. Prior to joining the Company, Mr. Hendry served as Business Operations Executive of Bank of America s Insurance Group, joining there from a merger with Countrywide Insurance Services Group. Prior to the merger, Mr. Hendry served as Managing Director and Chief Operating Officer for Countrywide and prior to this from 2004 to 2006 Mr Hendry served as Senior Vice President, Property and Casualty Services at

Safeco. From 1971-2004, Mr. Hendry held various leadership roles with CNA Insurance, with his last assignment being the Senior Vice President of Worldwide Operations.

PART II

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

The Company s Class A ordinary shares, $0.01 par value per share, are listed on the NYSE under the symbol XL.

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

	High	Low	Close
2009:			
1st Quarter	$ 6.44	2.56	5.46
2nd Quarter	12.45	5.20	11.46
3rd Quarter	18.19	10.83	17.46
4th Quarter	19.03	15.78	18.33
2008:			
1st Quarter	$ 52.26	$ 27.73	$ 29.55
2nd Quarter	38.30	20.33	20.56
3rd Quarter	23.60	13.50	17.94
4th Quarter	17.94	2.65	3.70

Each Class A ordinary share has one vote, except if, and so long as, the Controlled Shares (defined below) of any person constitute ten percent (10%) or more of the issued Class A ordinary shares, the voting rights with respect to the Controlled Shares owned by such person are limited, in the aggregate, to a voting power of approximately 10%, pursuant to a formula specified in the Company s Articles of Association. Controlled Shares includes, among other things, all Class A ordinary shares which such person is deemed to beneficially own directly, indirectly or constructively (within the meaning of Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, or Section 958 of the Internal Revenue Code of 1986, as amended).

The number of record holders of Class A ordinary shares as of December 31, 2009 was 357. This figure does not represent the actual number of beneficial owners of the Company s Class A ordinary shares because such shares are frequently held in street name by securities dealers and others for the benefit of individual owners who may vote the shares.

In 2009, four quarterly dividends were paid at $0.10 per share to all ordinary shareholders of record as of March 13, June 15, September 15 and December 15. In 2008, two quarterly dividends of $0.38 per share were paid to all ordinary shareholders of record as of March 14 and June 13 and two quarterly dividends of $0.19 per share were paid to all ordinary shareholders on record as of September 12 and December 9.

The declaration and payment of future dividends by the Company will be at the discretion of the Board of Directors and will depend upon many factors, including the Company s earnings, financial condition, business needs, capital and surplus requirements of the Company s operating subsidiaries and regulatory and contractual restrictions.

As a holding company, the Company s principal source of income is dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries in which the Company operates, including Bermuda, the U.S. and the U.K., and those of the Society of Lloyd s, and certain contractual provisions. In addition, if the proposed Redomestication is completed, but shareholders or the Irish High Court do not approve the creation of distributable reserves, the Company will not be able to pay dividends following the Redomestication unless sufficient earnings are generated. See Item 1A, Risk Factors, Risks Related to Redomestication , Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 26 to the Consolidated Financial Statements, Statutory Financial Data, for further discussion.

Information concerning securities authorized for issuance under equity compensation plans appears in Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Purchases of Equity Securities by the Issuer and Affiliate Purchases

The following table provides information about purchases by the Company during the quarter ended December 31, 2009 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) (2)
October				$ 375.5 million
November	3,023	$ 16.41		$ 375.5 million
December				$ 375.5 million
Total	3,023	$ 16.41		$ 375.5 million

(1) All shares were purchased in connection with the vesting of restricted shares granted under the Company s restricted stock plan. All of these purchases were made in connection with satisfying tax withholding

obligations of those employees. These shares were not purchased as part of the Company s share repurchase program noted below.

(2) On September 24, 2007, the Board of Directors of the Company approved a share repurchase program, authorizing the Company to repurchase up to $500.0 million of its Class A ordinary shares. During the year ended December 31, 2009, no share repurchases were made under the share repurchase program. As at December 31, 2009, the Company could repurchase $375.5

million of its
equity
securities
under the
share
repurchase
program.

Class A Ordinary Share Performance Graph

Set forth below is a line graph comparing the yearly dollar change in the cumulative total shareholder return, with all dividends reinvested, over a five-year period on the Company s Class A ordinary shares from December 31, 2004 through December 31, 2009 as compared to the cumulative total return of the Standard & Poor s 500 Stock Index and the cumulative total return of the Standard & Poor s Property & Casualty Insurance Index.

ITEM 6. SELECTED FINANCIAL DATA

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

	2009	2008	2007	2006	2005
			(U.S. dollars in thousands, except per share amounts)		
Income Statement Data:					
Net premiums earned	$ 5,706,840	$ 6,640,102	$ 7,205,356	$ 7,569,518	$ 9,365,4
Net investment income	1,319,823	1,768,977	2,248,807	1,978,184	1,475,0
Net realized (losses) gains on investments	(921,437)	(962,054)	(603,268)	(116,458)	241,8
Net realized and unrealized (losses) gains on derivative instruments	(33,647)	(73,368)	(55,451)	101,183	28,8
Net income (loss) income from investment fund affiliates (1)	78,867	(277,696)	326,007	269,036	154,8
Fee income and other	43,201	52,158	14,271	31,732	19,2
Net losses and loss expenses incurred (2)	3,168,837	3,962,898	3,841,003	4,201,194	7,434,3
Claims and policy benefits life operations	677,562	769,004	888,658	807,255	2,510,0

Acquisition costs, operating expenses and foreign exchange gains and losses	1,994,194	1,921,940	2,188,889	2,374,358	2,188,3
Interest expense	216,504	351,800	621,905	552,275	403,8
Extinguishment of debt		22,527			
Impairment of goodwill		989,971			
Amortization of intangible assets	1,836	2,968	1,680	2,355	10,7
Income (loss) before non-controlling interests, net income from operating affiliates and income tax expense	134,714	(872,989)	1,593,587	1,895,758	(1,261,9
Income (loss) from operating affiliates (1)(2)	60,480	(1,458,246)	(1,059,848)	111,670	67,4
Preference share dividends	80,200	78,645	69,514	40,322	40,3
Net income (loss) attributable to ordinary shareholders	206,607	(2,632,458)	206,375	1,722,445	(1,292,2

	2009	2008	2007	2006	
		(U.S. dollars in thousands, except per share amounts)			
Per Share Data:					
Net income (loss) per ordinary share basic (3)(7)	$ 0.61	$ (10.94)	$ 1.14	$ 9.55	$
Net income (loss) per ordinary share diluted (3)(7)	$ 0.61	$ (10.94)	$ 1.14	$ 9.53	$
Weighted average ordinary shares outstanding diluted (3)(7)	340,966	240,657	181,209	180,799	
Cash dividends per ordinary share	$ 0.40	$ 1.14	$ 1.52	$ 1.52	$
Balance Sheet Data:					
Total investments available for sale	$ 29,307,171	$ 27,464,510	$ 36,265,803	$ 39,350,983	$ 35
Cash and cash equivalents	3,643,697	4,353,826	3,880,030	2,223,748	3
Investments in affiliates.	1,185,604	1,552,789	2,611,149	2,308,781	2
Unpaid losses and loss expenses recoverable	3,584,028	3,997,722	4,697,471	5,027,772	6
Premiums receivable.	2,597,602	3,135,985	3,637,452	3,591,238	3
Total assets	45,579,675	45,648,814	57,762,264	59,308,870	58
Unpaid losses and loss	20,823,524	21,650,315	23,207,694	22,895,021	23

expenses									
Future policy benefit reserves		5,490,119		5,452,865		6,772,042		6,476,057	5
Unearned premiums		3,651,310		4,217,931		4,681,989		5,652,897	5
Notes payable and debt		2,451,417		3,189,734		2,868,731		3,368,376	3
Shareholders equity		9,432,417		6,116,831		9,950,561		10,693,287	8
Fully diluted book value per ordinary share	$	24.60	$	15.46	$	50.29	$	53.01	$
Operating Ratios:									
Loss and loss expense ratio (4)		61.5 %		66.2 %		59.8 %		62.2 %	
Underwriting expense ratio (5)		32.1 %		28.7 %		29.0 %		27.3 %	
Combined ratio (6)		93.6 %		94.9 %		88.8 %		89.5 %	

(1) The Company records the income related to alternative fund affiliates on a one month lag and the private investment fund affiliates on a three month lag in order for the Company to meet the accelerated filing deadlines as this is the most current information available at the date of filing. The

Company records the income related to operating affiliates on a three month lag.

(2) In 2008, net loss from operating affiliates includes losses totaling approximately $1.4 billion related to the closing of the Master Agreement as well as losses recorded throughout 2008 and up until the closing of the Master Agreement that were associated with previous reinsurance and guarantee agreements with Syncora. In 2007, $351.0 million of financial guarantee reserves related to reinsurance agreements with Syncora were recorded within net loss from operating affiliates.

(3) Effective for the fiscal year beginning January 1, 2009 and for all interim periods within 2009, the Company adopted final

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

pursuant to the two-class method. Under the terms of the Company s restricted stock awards, grantees are entitled to receive dividends on the unvested portions of their awards. There is no requirement to return these dividends in the event the unvested awards are forfeited in the future. Accordingly, this guidance had an impact on the Company s EPS calculations. All prior period EPS data presented has been adjusted retrospectively to conform to the provisions of this guidance. The adoption of this guidance reduced basic loss per ordinary share for fiscal 2008 and fiscal 2005 by $0.08 and $0.08, respectively, and reduced basic earnings per ordinary share by $0.02, and $0.08 for fiscal 2007 and fiscal 2006, respectively, and reduced diluted loss per ordinary share for fiscal 2008 $0.08 and fiscal 2005 by

$0.08, respectively, and reduced diluted earnings per ordinary share by $0.01 and $0.07, for fiscal 2007 and fiscal 2006, respectively.

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

(5) The underwriting expense ratio related to the property and casualty operations is the sum of acquisition expenses and operating expenses for the Insurance and Reinsurance segments divided by net premiums earned for the Insurance and Reinsurance segments. See Item 8, Note 6 to the Consolidated Financial Statements, Segment Information, for

further information.

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

(7) Effective April 1, 2009 the Company adopted final authoritative guidance that addressed the treatment of credit losses on investments. This guidance was not applied retroactively. For additional information see Item 8, Note 2(r) to the Consolidated Financial Statements Recent Accounting Pronouncements .

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

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

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

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

Index

Executive Overview	61
Results of Operations and Key Financial Measures	64
Significant Items Affecting the Results of Operations	67
Other Key Focuses of Management	71
Critical Accounting Policies and Estimates	74
Segments	89
Income Statement Analysis	90
Insurance	90
Reinsurance	93
Life Operations	96
Syncora	98
Investment Activities	98
Investment Performance	99
Net realized gains and losses on investments	101
Net realized and unrealized gains and losses on derivative	101

instruments	
Other Revenues and Expenses	101
Balances Sheet Analysis	103
Investments	103
Gross and net unrealized gains and losses on investments	104
Fair Value Measurements of Assets and Liabilities	111
Unpaid Losses and Loss Expenses	113
Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable	113
Liquidity and Capital Resources	114
Cross-Default and Other Provisions in Debt Instruments	123
Long-Term Contractual Obligations	123
Variable Interest Entities and Other Off-Balance Sheet Arrangements	124
Recent Accounting Pronouncements	125
Cautionary Note Regarding Forward-Looking Statements	125

Executive Overview

Background

The Company through its subsidiaries, is a global insurance and reinsurance company providing property, casualty and specialty products to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. The Company operates in markets where it believes its underwriting expertise and financial strength represent a relative advantage.

The Company has grown through acquisitions and development of new business opportunities. Acquisitions included Global Capital Re in 1997, Mid Ocean Limited in 1998, ECS, Inc. and NAC Re Corp. in 1999, Winterthur International in 2001 and Le Mans Re in 2002. All acquisitions were entered into in order to further support the Company s strategic plan to develop a global platform in insurance and reinsurance. The Company competes as an integrated global business and at December 31, 2009 employed 3,565 employees in 24 countries. For further information in relation to the Company s Operations, see Item 1, Business.

Underwriting Environment

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

Insurance

Throughout 2009, renewal pricing in the Insurance segment experienced a modest overall increase of 1% across the entire book as compared to a 6% decrease in rates for the same period a year ago. There was overall a steady improvement in pricing throughout the year, resulting in full year increases in specialty lines of 3% and casualty lines of 1% being offset by a decrease of 1 % in property lines while professional lines pricing has been flat. Premium volumes were also negatively impacted by global economic conditions, which drove ratable exposure bases down and reduced mergers and acquisitions activity. The impact of the ratings downgrade by Standard & Poors (S&P) in December 2008 affected premiums particularly in certain longer tail lines, but this impact continued to lessen throughout the year as the Company s financial position improved. The Company exited certain lines of business, non-renewed certain programs, and was exposed to the ongoing efforts of risk managers to reduce concentrations of risk (limits) with all of their insurers. However, retention rates ended the year at just less than 80% for all lines of business with property and casualty lines in the low to mid 80s. In the fourth quarter of 2009 pricing showed continued improvement with a positive aggregate price change of 1.4% with notable positive price changes in professional of 2% and aerospace of 9% offset by a 2% reduction in property rates reflecting the markets recent pricing behavior. For further information on recent rate and renewal activity, see 2010 Underwriting Outlook below.

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

	2009			2008 (3)		
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiu Earne**
Casualty professional lines	$ 1,423,756	1,336,541	1,276,005	$ 1,472,874	$ 1,351,237	$ 1,369,
Casualty other lines	947,121	570,887	655,126	1,273,016	793,512	822,
Other property	649,592	361,841	426,441	886,418	503,387	471,
Marine, energy, aviation, and satellite	644,898	516,408	546,806	747,311	604,786	621,
Other specialty lines (1)	577,804	483,166	634,436	850,404	712,307	660,
Other (2)	5,257	1,077	12,217	22,736	(22,908)	(11,
Structured indemnity	3,460	3,460	8,762	56,155	42,505	62,
Total	$ 4,251,888	3,273,380	3,559,793	$ 5,308,914	$ 3,984,826	$ 3,997,

(1) Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, specie, middle markets and excess and surplus lines.

(2) Other includes credit and surety

and other lines.

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

Reinsurance

Across the Reinsurance segment, market conditions during 2009 remained stable but competitive, with the majority of classes experiencing flat rate movement. US property catastrophe margins improved as rates increased by up to 8% on an exposure adjusted basis. Non-US catastrophe rates were generally flat, but there was rate fluctuation in some territories from -5% to +5%. Non-catastrophe property lines of business showed flat rates for the year. Loss activity provided momentum to increase aviation rates by 10% across the sector.

US casualty rates were flat to down 5%, while non-US casualty rates were flat where the market remained disciplined. July 1 is one of the main renewal periods for Latin American business and substantial capacity in the market for most lines, terms and conditions remained firm in the region.

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

	2009			2008		
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Ne Prem Ear**
Casualty professional lines	$ 170,928	$ 166,903	$ 196,624	$ 213,519	$ 213,498	$ 2
Casualty other lines	218,778	217,889	257,610	356,723	347,849	4
Property catastrophe.	357,267	312,321	312,780	401,740	290,443	3
Other property	862,310	553,556	560,379	947,899	602,423	6
Marine, energy, aviation, and satellite	89,100	82,393	83,532	119,593	104,346	1
Other (1)	156,092	132,322	172,588	220,332	194,237	2
Structured indemnity	4,948	4,948	8,433	671	671	
Total	$ 1,859,423	$ 1,470,332	$ 1,591,946	$ 2,260,477	$ 1,753,467	$ 1,9

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

The following sets forth potential trends relevant to the Company s property and casualty operations in 2010:

2010 Underwriting Outlook

Given the challenging economic environment that has been experienced throughout 2008 and 2009 including the downgrade of the financial strength ratings of the Company s leading insurance and reinsurance subsidiaries by leading rating agencies, the Company shifted focus to those lines of business

within its insurance and reinsurance operations that provide the best return on capital. As such, the Company has been highly selective on new business, emphasizing short-tail lines, where applicable, in the Company s reinsurance operations, exiting other businesses (e.g., Casualty facultative business), non-renewing certain insurance programs, as well as continuing to reduce long-term agreements (within the insurance operations) in order to capture the benefit of hardening markets.

Following the catastrophe activity of 2008, most notably, losses resulting from Hurricanes Ike and Gustav, and more importantly, following severe economic conditions and the impacts of the financial crisis, which reduced the available capital of many property and casualty (re)insurers, market capacity decreased and in conjunction, market pricing across most insurance and reinsurance lines of business began to improve in the early part of 2009. Despite these early improvements, credit spreads narrowed sharply throughout 2009, and the credit markets brought capital back into the market, strengthening balance sheets and putting increased pressure on market pricing. The following is a summary of the January 2010 rate indications and recent renewal activity for each of the Insurance and Reinsurance segments of the Company:

Insurance

With regard to market conditions within the core lines of business within the Insurance segment, fourth quarter 2009 renewals reflected modest improvement in market conditions as premium rates continued to stabilize across several lines of business and certain lines experienced rate increases. Overall, fourth quarter 2009 renewals reflected an aggregate price increase of 1% for the entire book. More specifically, premium rates increased approximately 2% in both the professional and the specie books of business, 1% in both casualty and offshore energy, and over 9% in the Company s aerospace book of business. Rates in both property and environmental were down in the low single digits.

While the actions taken in 2009 have impacted both gross and net premiums written, the Company s decision to focus on those lines of business that provide the best return on capital was successfully implemented. In fact, indications from recent underwriting activity highlight that renewals from the Company s European book, where just less than 50% of the book renews on January 1, were strong across all product lines, particularly casualty, at 88%, and property, at 86%. Pricing based on the January 2010 renewals continued to show rate improvement with an aggregate rate increase of 1% compared to rate declines in January 2009 of minus 2%.

Reinsurance

Across the Reinsurance segment, initial indications, based on January 1, 2010 renewals, points to an increase in renewable premium of 6% with almost half of this increase being driven by recaptured business that was lost at the end of 2008 due to security concerns by customers. The reminder of the increase was through new business opportunities and increased catastrophe capacity in certain regions. However, there was a moderate decrease in premium rates across most major lines of business. Market rates are flat, with softening where loss activity was low in 2009. U.S. and non-U.S. catastrophe exposed property lines experienced rate decreases of approximately 7.5% and 5.0% respectively, while other property lines in the U.S. were generally flat. While U.S. casualty rates, excluding D&O, were down slightly, casualty motor rates in Europe saw increases of up to 10% with rates in other casualty lines remaining flat. In addition, aviation and marine lines of business experienced rate increases of up to 10% whereas rates for the large property risks in Latin America continue to weaken.

Looking ahead for the remainder of 2010, while the reinsurance market remains disciplined, the segment is impacted by the competitive conditions already outlined in the insurance segment above. The reinsurance segment will continue its philosophy of disciplined underwriting and will shrink the portfolio if market conditions do not warrant deploying capital.

Investment Environment

The Company seeks to generate revenue from investment activities through returns on its investment portfolio. The Company s current investment strategy seeks to support the liabilities arising from the operations of the Company, generate investment income and build book value over the longer term.

During the year ended December 31, 2009, financial market conditions continued to be extremely volatile, characterized by increasing long term global interest rates over the course of the year, combined with deterioration in credit markets early in the year, followed by rallies in credit markets in the latter half of the year. There was also significant quarter-to-quarter volatility during the year. The Company s results of operations and investment portfolio during the year ended December 31, 2009 were impacted by these trends. Net investment income yields were negatively impacted as a result of lower short-term interest rates, particularly U.S. LIBOR, on floating rate assets, higher allocations to lower yielding government, agency and cash securities as a result of the Company s derisking efforts, and reduced prevailing yields on reinvestment income. Net realized losses resulted from sales transactions in relation to the Company s de-risking efforts, and other- than-temporary impairment charges relating to the deterioration of future cash flow estimates, particularly in the non-agency RMBS and medium-term notes asset classes. Net unrealized losses for the Company declined as a result of both the mark-to-market impact of the credit rally during the year and the impact of realized losses on the year, offset by the effect of increasing interest rates. For further information, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Investment Activities

Claims Environment

The Company s profitability in any given period is based upon its premium and investment revenues as noted above, less net losses incurred and expenses. Net losses incurred are based upon claims paid and changes to unpaid loss reserves. Unpaid loss reserves are estimated by the Company and include both reported loss reserves and reserves for losses incurred but not reported, or IBNR. The Company s improved underwriting results for 2009 as compared to 2008 were largely due to minimal large loss activity in 2009 compared to the catastrophe and property risk losses experienced in 2008. In addition, included in the current year incurred losses was $284.7 million of net favorable prior year reserve development in various lines of business within the Company s Insurance and Reinsurance segments. In contrast, the Company s lower underwriting results for 2008 as compared to 2007 were largely a reflection of the increase in catastrophe and property risk losses experienced in 2008 offset by net favorable development of prior year s reserves of $610.7 million. In addition, during 2007 and 2008, claims activity within the D&O and Errors and Omissions (E&O) insurance markets overall, rose as a result of an increase in class action lawsuits filed against public companies due to market losses and related stock price depreciation associated with the sub-prime mortgage and credit crisis in the U.S. This sub-prime related claim activity decreased during 2009. Management actively monitors its potential exposure to potential clash events such as sub-prime mortgage developments and gives due consideration to emerging claim trends in determining its loss reserve requirements at each quarter end. For further analysis of this exposure, see Results of Operations below.

Results of Operations and Key Financial Measures

The following table presents an analysis of the Company s net income (loss) attributable to ordinary shareholders and other financial measures (described below) for the years ended December 31, 2009, 2008 and 2007:

(U.S. dollars in thousands, except share and per share amounts)		**2009**		**2008**		**2007**
Net income (loss) attributable to ordinary shareholders	$	206,607	$	(2,632,458)	$	206,375
Earnings (loss) per ordinary share basic	$	0.61	$	(10.94)	$	1.14
Earnings (loss) per ordinary share diluted	$	0.61	$	(10.94)	$	1.14
Weighted average number of ordinary shares and ordinary share equivalents basic		340,612		240,657		180,353
Weighted average number of ordinary shares and ordinary share equivalents diluted		340,966		240,657		181,209

The following are some of the financial measures management considers important in evaluating the Company s operating performance in the Company s property and casualty operations:

(U.S. dollars in thousands, except ratios and per share amounts)	**2009**	**2008**	**2007**
Underwriting profit property and casualty operations	$ 327,306	$ 303,017	$ 723,939
Combined ratio property and casualty operations	93.6 %	94.9 %	88.8 %
Net investment income property and casualty operations (1)	$ 882,748	$ 1,174,856	$ 1,289,554
Book value per ordinary share	$ 24.64	$ 15.46	$ 50.30
Fully diluted book value per ordinary share (2)	$ 24.60	$ 15.46	$ 50.29
Return on average ordinary shareholders equity	3.1 %	NM*	2.2 %

(1) Net investment income relating to property and casualty operations does not include the net investment income related to the net results from structured products.

(2) Fully diluted book value per ordinary share, a non GAAP measure, represents book value per ordinary share combined with the

impact from dilution of share based compensation including in-the-money stock options at any period end. The Company believes that fully diluted book value per ordinary share is a financial measure important to investors and other interested parties who benefit from having a consistent basis for comparison with other companies within the industry. However, this measure may not be comparable to similarly titled measures used by companies either outside or inside of the insurance industry.

* NM Not Meaningful

Key Financial Measures

Underwriting profit property and casualty operations

One way that the Company evaluates the performance of its insurance and reinsurance operations is the underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written.

Underwriting profit or loss is calculated from premiums earned less net losses incurred and expenses related to underwriting activities. The Company s underwriting profit in the year ended December 31, 2009 was primarily reflective of the combined ratio discussed below.

Combined ratio property and casualty operations

The combined ratio for property and casualty operations is used by the Company and many other insurance and reinsurance companies as another measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net premiums earned for the Company s insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss. The Company s combined ratio for the year ended December 31, 2009, is slightly lower than the same period in the previous year, primarily as a result of a decrease in the loss and loss expense ratio, partially offset by an increase in the underwriting expense ratio. The loss and loss expense ratio has declined as a result of lower levels of catastrophe losses in both the insurance and reinsurance segments and lower current year professional lines losses in the insurance segment partially offset by larger prior year reserve releases reported in 2008. The increased underwriting expense ratio has been driven largely by increases in operating expenses against lower net premiums earned. Operating expenses increased mainly as a result of the Company s two restructuring activities as described further below. Going forward, with the two restructuring initiatives now essentially complete, we expect our targeted cost savings will be reflected in a lower 2010 expense ratio.

The Company s combined ratio for the year ended December 31, 2008, was higher than the previous year, primarily as a result of an increase in the loss and loss expense ratio as well as the underwriting expense ratio. The higher loss and loss expense ratio resulted from higher current year attritional and catastrophe losses, primarily in property lines, combined with lower net premiums earned in the year ended December 31, 2008, as compared to 2007, as a result of the continuing competitive underwriting environment and softening market conditions noted above. The higher 2008 loss ratio also results from a higher level of loss activity in professional lines due to the subprime and related credit crises. Partially offsetting the increase in incurred losses was higher favorable prior year reserve development during the year ended December 31, 2008. While acquisition expenses decreased during the year ended December 31, 2008 as compared to 2007, the increase in operating expenses combined with the impact from the lower level of net premiums earned caused an increase in the underwriting expense ratio.

Net investment income property and casualty and corporate operations

Net investment income related to property and casualty and corporate operations is an important measure that affects the Company s overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Company s investment portfolio provides liquidity for claims settlements of these reserves as they become due. Thus, a significant part of the investment portfolio is invested in fixed income securities. Net investment income is influenced by a number of factors, including the amounts and timing of inward and outward cash flows, the level of interest rates and credit spreads and changes in overall asset allocation. Net investment income related to property and casualty and corporate operations decreased by $398.6 million during 2009 as compared to same period in the prior year. Overall, portfolio yields have decreased as a result of the impact of declines in U.S. interest rates, and particularly the impact of decreased U.S. Dollar Libor on the Company s floating rate securities previously supporting the GIC and funding agreement business. In addition, the Company increased its holdings in lower-yielding cash, government and agency RMBS securities in connection with its investment portfolio de-risking efforts as the Company re-aligns its portfolio to one more typical of a P&C portfolio and to increase liquidity.

Net investment income related to property and casualty operations, excluding structured products, decreased by $114.7 million during the year ended December 31, 2008, as compared to 2007. Overall, investment portfolio yields decreased in 2008 as yields earned on investment of cash flows and reinvestment of maturing or sold securities were generally lower than on securities previously held, as prevailing market interest rates, particularly in the U.S., decreased overall during 2008. The investment portfolio mix also changed as a result of the settlement of the GIC and funding agreement liabilities, as the property and casualty operations assumed a number of the floating rate securities previously held in the Company s Other Financial Lines segment and accordingly, net investment income is more sensitive to changes in short-term interest rates. The Company also increased allocations to lower yielding cash, government and agency RMBS investments.

Book value per ordinary share

Management also views the change in the Company s book value per ordinary share as an additional measure of the Company s performance. Book value per share is calculated by dividing ordinary shareholders equity by the number of outstanding ordinary shares at any period end. Book value per ordinary share is affected primarily by the Company s net income (loss), by any changes in the net unrealized gains and losses on its investment portfolio, currency translation adjustments and also the impact of any share repurchase or issuance activity.

Book value per ordinary share increased by $9.14 in the year ended December 31, 2009 as compared to a decrease of $34.83 during 2008. During 2009, there was a decrease in net unrealized losses of $2.2 billion, net of tax. Although there was significant quarter to-quarter volatility, in aggregate the impact of tightening credit spreads combined with the benefit from declining interest rates resulted in overall increased book value. Book value was further increased by the issuance of 11,461,080 shares issued at $65.00 per share upon the maturity of the purchase contracts associated with the 7.0% Equity Security Units, as such issuance was accretive to book value. In addition, book value per ordinary share increased as a result of net income attributable to ordinary shareholders of $206.6 million which included a $211.8 million gain associated with the purchase of a portion of the Company s Redeemable Series C Preference Ordinary Shares.

Book value per ordinary share decreased by $34.83 in the year ended December 31, 2008 as compared to a decrease of $2.72 during 2007. The decrease in 2008 was primarily as a result of the Company s issuance of Class A ordinary shares issued at a discount to book value (as described below), the Company s net loss of $2.6 billion during the year ended December 31, 2008 and the increase in net unrealized losses on investments of approximately $2.9 billion, net of tax, during the same period. In addition, book value per ordinary share decreased as a result of unfavorable foreign currency translation adjustments of $472.3 million during the year ended December 31, 2008. In August 2008, the Company issued 143.8 million Class A ordinary shares at a price of $16.00 per share, which was lower than the Company s book value per ordinary share at the time and thus dilutive. The Company s net loss of $2.6 billion was

mainly due to the impact of the closing of the Master Agreement in August 2008 as described above, the goodwill impairment charge recorded in 2008 of $990.0 million, catastrophe and attritional losses, as well as from

net realized losses on investments and losses from investment fund affiliates during the year ended December 31, 2008. The decrease in net unrealized losses on investments of $2.2 billion, net of tax, during the year ended December 31, 2009 was mainly as a result of tightening credit spreads on corporate and structured credit assets and realized losses incurred during the year, offset by increases in prevailing government interest rates.

As noted above, fully diluted book value per ordinary share represents book value per ordinary share combined with the impact from dilution of share based compensation including in-the-money stock options at any period end. Fully diluted book value per ordinary share increased by $9.14 and decreased by $34.83 during the years ended December 31, 2009 and 2008, respectively, as a result of the factors noted above.

Return on average ordinary shareholders equity

Return on average ordinary shareholder s equity (ROE) is another financial measure that management considers important in evaluating the Company s operating performance. ROE is calculated by dividing the net income for any period by the average of the opening and closing ordinary shareholders equity. The Company establishes minimum target ROEs for its total operations, segments and lines of business. If the Company s minimum ROE targets over the longer term are not met with respect to any line of business, the Company seeks to modify and/or exit these lines. In addition, among other factors, the Company s compensation of its senior officers is dependent on the achievement of the Company s performance goals to enhance shareholder value as measured by ROE (adjusted for certain items considered to be non-operating in nature).

In 2009, ROE was 3.1%, significantly higher than the same period in the prior year when it was negative, mainly as a result of the closing of the Master Agreement in August 2008 as described above. Shareholders equity increased over the past twelve months mainly as a result of the decreases in unrealized losses on investments and favorable foreign exchange translation adjustments during this period.

In 2008, ROE was negative, mainly as a result of the impact of the closing of the Master Agreement in August 2008 as described above, the goodwill impairment charge recorded in late 2008, as well as from catastrophe losses, net realized losses on investments and losses from the Company s investment fund affiliates during the year ended December 31, 2008.

Significant Items Affecting the Results of Operations

The Company s net income (loss) and other financial measures as shown above for the three years ended December 31, 2009, 2008 and 2007 have been affected by among other things, the following significant items:

1) impact of credit market movements in 2009, 2008 and 2007 on the Company s investment portfolio and investment fund affiliates;

2) impact of the closing of the Master Agreement (discussed below) in August 2008 and the impact in 2007 of the Company s investment in and relationships with Syncora;

3) continuing competitive underwriting environment;

4) net favorable prior year loss development;

5) impact of increased property risk and catastrophe activity in 2008 and limited property risk catastrophe activity in 2009 and 2007;

6) goodwill impairment charge recorded in 2008;

7) redemption of a portion of the Company s Series C Preference Ordinary Shares;

8) impact of restructuring and asset impairment charges.

1. Impact of credit market movements in 2009, 2008 and 2007 on the Company s investment portfolio and investment fund affiliates

During the year ended December 31, 2009, financial market conditions continued to be extremely volatile, characterized by increasing long-term global interest rates over the course of the year, combined with deterioration in credit markets early in the year, followed by rallies in credit markets in the last three

quarters of the year. The net impact of the market conditions on the Company s investment portfolio for the year resulted in a decrease in net unrealized losses on available for sale investments as compared to December 31, 2008 of $2.1 billion. This represents approximately a 4.5% appreciation on average assets for the year ended December 31, 2009.

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

	Interest Rate Movement for the year ended December 31, 2009 (1) (+ / - represents increases / decreases in interest rates)	**Credit Spread Movement for the year ended December 31, 2009 (2) (- represents tightening of credit spreads)**
United States	+ 114 basis points (5 year Treasury)	- 453 basis points (US Corporate A rated)
	- 117 basis points (3 month LIBOR)	- 151 basis points (US Agency RMBS, AAA rated)
		- 579 basis points (US CMBS, AAA rated)
United Kingdom	+ 100 basis points (10 year Gilt)	- 185 basis points (UK Corporate, AA rated)
Euro-zone	+ 11 basis points (5 year Bund)	- 265 basis points (Europe Corporate, A rated)

(1) Source: Bloomberg Finance L.P.

(2) Source: Merrill Lynch Global Indices.

Net realized losses on investments in the year ended December 31, 2009 totaled $921.4 million, included net realized losses of approximately $812.5 million related to the impairment of certain of the Company s fixed income, equity and other investments, where the Company determined that there was an other-than- temporary decline in the value of those investments. For further analysis of this, see Results of Operations below.

Of the $921.4 million, there was net realized losses of $406.6 million related to credit impairments on structured credit securities. Primarily these represented below investment grade non-Agency RMBS, including those with sub-prime and Alt-A collateral. A further $226.9 million in net realized losses related to impairments of medium term notes backed primarily by investment grade European credit and $160.6 million of impairments related primarily to the intent to sell certain Tier One and Upper Tier Two securities. The remaining impairment during the year was spread across the investment portfolio including equities and other fixed income investments. Consistent with prior years, management continues to evaluate the impairment of the investment portfolio and satisfy itself that the remaining

gross unrealized losses are temporary in nature.

2. Impact of the closing of the Master Agreement in August 2008 and the impact in 2007 of the Company s investment in and relationships with Syncora

On July 28, 2008, the Company announced that it and certain of its subsidiaries had entered into an agreement (the Master Agreement) with Syncora and certain of its subsidiaries (sometimes collectively referred to herein as Syncora) as well as certain counterparties to credit default swap agreements (the Counterparties), in connection with the termination of certain reinsurance and other agreements. The transactions and termination of certain reinsurance and other agreements under the Master Agreement closed on August 5, 2008. For a description of the Master Agreement, see Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd. (Syncora).

After the closing of the Master Agreement on August 5, 2008, approximately $64.6 billion of the Company s total net exposure (which was $65.7 billion as at June 30, 2008) under reinsurance agreements and guarantees with Syncora subsidiaries was eliminated. Pursuant to the terms of the Master Agreement, Syncora is required to use commercially reasonable efforts to commute the agreements that are the subject of the Company s guarantee of Syncora Guarantee s obligations under certain financial guarantees issued by Syncora Guarantee to the European Investment Bank (the EIB Policies), subject to certain limitations. As at December 31, 2009, the Company s exposure relating to the EIB Policies (which relate to project finance transactions) was approximately $920.4 million as compared to $955.4 million at December 31, 2008, decreasing mainly due to the strengthening of the U.S. dollar against the currencies of the underlying obligations. As of December 31, 2009, there had been no reported events of default on the underlying obligations. Accordingly, no reserves have been recorded.

The terms of the Master Agreement were agreed in consideration of a number of commercial and economic factors associated with all existing relationships with Syncora, including, but not limited to, a valuation of the consideration for the commuted agreements and any potential future claims there under and the impact of outstanding uncertainty on both the ratings and business operations of the Company. The total value of the consideration noted above of $1.775 billion as well as the eight million ordinary shares of the Company transferred to Syncora valued at $128.0 million, significantly exceeded the carried net liabilities of approximately $490.7 million related to such reinsurances and guarantees. Management considers the execution of the Master Agreement as the event giving rise to the additional liability. As detailed in the table below, the Company recorded a loss of approximately $1.4 billion in respect of the closing of the Master Agreement during the year ended December 31, 2008:

(U.S. dollars in millions)		
Carried liabilities in relation to reinsurance and guarantee agreements commuted under the Master Agreement	$	490.7
Other accruals		(5.2)
Cash payment made to Syncora in August 2008		(1,775.0)
Value of XL common shares transferred under the Master Agreement		(128.0)
Net loss associated with Master Agreement recorded in the year ended December 31, 2008	$	(1,417.5)

Given management s view of the risk exposure along with the uncertainty facing the entire financial guarantee industry in the latter part of 2007, the Company reduced the reported value of its investment in Syncora to nil at December 31, 2007, from the reported equity method value of $669.8 million as at September 30, 2007. In addition, net losses were recorded in 2007 within loss from operating affiliates with respect to the previous excess of loss and facultative reinsurance of Syncora subsidiaries in the amounts of $300.0 million and $51.0 million, respectively. In addition, during 2007, the Company incurred $17.9 million in additional mark-to-market losses related to those underlying contracts in credit default swap form subject to the provisions noted above.

3. Continuing competitive underwriting environment

Soft market conditions were experienced across most lines of business throughout 2007, 2008 and 2009, resulting in an overall decrease in gross and net premiums written. For further information in relation to the underwriting environment, including details relating to rates and retention, see Executive Overview - Underwriting Environment , above.

4. Net favorable prior year loss development

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

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

(U.S. dollars in millions)	**2009**	**2008**	**2007**
Insurance segment	$ (62.9)	$ (305.5)	$ (158.1)
Reinsurance segment	(221.8)	(305.2)	(267.3)
Total	$ (284.7)	$ (610.7)	$ (425.4)

During 2009, net favorable prior year development totaled $284.7 million in the Company s property and casualty operations and included net favorable development in the Insurance and Reinsurance segments of $62.9 million and $221.8 million, respectively. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 12 to the Consolidated Financial Statements, Losses and Loss Expenses , for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of the Company s operating segments.

5. Impact of increased property risk and catastrophe activity in 2008 and limited property risk and catastrophe activity in 2009 and 2007

Current year net losses in 2009 decreased by $794.1 million over 2008, primarily due to lower levels of large property risk and catastrophe losses occurring in the current year as compared to 2008. On September 1, 2008, Hurricane Gustav hit the Louisiana coast of the U.S. as a Category 2 hurricane, causing considerable damage to insured property and loss of life. On September 13, 2008, Hurricane Ike made landfall near Galveston, Texas as a strong Category 2 hurricane, causing significantly more damage and loss of life than Hurricane Gustav. Hurricane Ike was the third costliest hurricane to ever make landfall in the U.S. In 2008, the Company incurred losses, net of reinsurance recoveries and reinstatement premiums, of $22.5 million and $210.0 million related to Hurricanes Gustav and Ike, respectively. In addition to natural peril catastrophes, there was also an increase in large property risk losses globally during 2008 that contributed to higher loss ratios in both the Insurance and Reinsurance segments.

Overall, 2009 and 2007 experienced a lower number of natural catastrophes as compared to 2008. In 2009, natural catastrophes included Hailstorm Wolfgang, Japanese earthquake, Windstorm Klaus, Typhoon Ketsana, Asian earthquake and tsunami and Australian wildfires. In 2007, six hurricanes formed in the Atlantic region including two Category 5 hurricanes, while other natural catastrophes in 2007 included European windstorms Kyrill and Per/Hanno, California wildfires, floods in the U.K. and Mexico, the Peruvian earthquake and five hurricanes in the Eastern Pacific region.

6. Goodwill impairment charge recorded in 2008

Due to the financial market and economic events that occurred in the fourth quarter of fiscal 2008, the Company performed an interim impairment test for goodwill subsequent to its annual testing date of June 30. The interim impairment test resulted in a non-cash goodwill impairment charge of $990.0 million. The charge relates primarily to certain reinsurance unit goodwill associated with the merger of Mid Ocean Limited (Mid Ocean) in 1998. The fair value of the Mid Ocean reporting unit was calculated using the methodologies as described within Critical Accounting Policies and Estimates below, and by comparison with similar companies using their publicly traded price multiples as the basis for valuation. For further information, see Item 8, Note 7 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets, and see further discussion under Critical Accounting Policies and Estimates .

7. Redemption of a portion of the Company s Series C Preference Ordinary Shares

On March 26, 2009, the Company completed a cash tender offer for its outstanding Series C Preference Ordinary Shares that resulted in approximately 12.7 million Series C Preference Ordinary Shares with a liquidation value of $317.3 million being purchased by the Company for approximately $104.7 million plus accrued and unpaid dividends, combined with professional fees totaling $0.8 million. As a result, a book value gain to ordinary shareholders equity of approximately $211.8 million was recorded.

Subsequent to December 31, 2009 the Company repurchased 4.4 million Series C Preference Ordinary Shares with a liquidation value of $110.8 million for approximately $94.2 million.

8. Restructuring and asset impairment charges

During the third quarter of 2008 and the first quarter of 2009, expense reduction initiatives were implemented in order to reduce the Company s operating expenses. The goal of these initiatives was to achieve enhanced efficiency and an overall reduction in operating expenses by streamlining processes across all geographic locations, with a primary emphasis on corporate functions. To date, this has been achieved through reductions in redundancies, increased outsourcing and the cessation of certain projects and activities. Charges have been recognized and accrued as restructuring and asset impairment charges and allocated to the Company s reportable segments in accordance with authoritative guidance over accounting for costs associated with exit or disposal activities and guidance over

accounting for the impairment or disposal of long-lived assets. Other costs that do not meet the criteria for accrual are being expensed as restructuring charges as they are incurred. Restructuring charges relate mainly to employee termination benefits as well as costs associated with ceasing to use certain leased property accounted for as operating leases. Asset impairment charges relate primarily to the write-off of certain IT system and equipment costs

previously capitalized. The Company recognizes an asset impairment charge when net proceeds expected from disposition of an asset are less than the carrying value of the asset and reduces the carrying amount of the asset to its estimated fair value. For the years ended December 31, 2009 and 2008 costs incurred in relation to the restructuring and asset impairment charges noted above are $81.5 million and $50.8 million, respectively. These charges have been recorded in the Company s income statement under Operating Expenses . See Item 8, Note 5 to the Consolidated Financial Statements, Restructuring and Asset Impairment Charges , for further information regarding the actual and expected costs for each of the years indicated within each of the Company s operating segments.

Other Key Focuses of Management

Throughout the latter part of 2008 and 2009 and into 2010, the Company remains focused on, among other things, simplifying the Company s business model to focus on core property and casualty business and enhancing its enterprise risk management capabilities. Details relating to these initiatives are highlighted below.

Simplify the Company s Business Model and Enhance Risk Management

In relation to this top management priority, certain initiatives that have taken place or are underway include the following:

Focus on P&C Businesses: As previously announced, the Company is focusing on those lines of business within its Insurance and Reinsurance segments that provide the best return on capital. As such, the Company will continue to be highly selective on new business, emphasize short-tail lines, where applicable, in the Company s Reinsurance segment, exit other businesses (e.g., Casualty facultative business), non-renew certain insurance programs. In

addition, in December 2008 the Company completed a strategic review of its Life reinsurance business. In connection therewith, the Company announced that it sold renewal rights to a portion of its European life, accident and health reinsurance business, a relatively small block of business, and it will run-off its existing book of U.K. and Irish life and annuity business. In addition, during December 2009, the Company sold its U.S. life reinsurance business.

Enterprise Risk Management: The Company is focused on enhancing its risk management capabilities throughout all facets of its operations. This initiative is led by the Company s Chief Enterprise Risk Officer (CERO) and is supported by, among others, the Company s ERC

comprised of the most senior risk management executives of the Company. The ERM Committee will continue to assist with the efficient identification, assessment, monitoring and reporting of key risks across the Company. See Item 1, Business Enterprise Risk Management for further information.

Simplify P&C Investment Portfolio: The Company has continued to reposition the Company s P&C investment portfolio to one that supports a P&C focused operation so that a) book value volatility, particularly related to credit spreads arising from the investment portfolio, is reduced, b) a reduction in lower rated corporate securities and financial issuers is achieved, c) exposure to commercial mortgage-backed

securities (CMBS) is reduced and d) a reduction in asset classes such as sub-prime, Alt-A and Core collateralized debt obligations (CDO s) previously supporting the guaranteed investment contract and funding agreement businesses is achieved.

The Company estimates that its derisking efforts within the P&C investment portfolio are now approximately 80% complete in terms of the potential mark-to-market that would arise from a repeat of the credit crisis of January 2007 to March 2009. The estimated mark to market represents estimated modeled portfolio level results, rather than individual security level results. Although the actual P&C investment portfolio lost approximately $4.0 billion of mark to market

over this period, it is estimated that the P&C investment portfolio, as structured at December 31, 2009, would have lost $1.6 billion over this period. The Company s target P&C SAA benchmark would have lost approximately $1.0 billion over the same period. As a result of this progress, the Company will now focus on optimizing the P&C investment portfolio, as compared to its previous focus on pure de-risking. Accordingly, the remaining positions in legacy asset classes such as Agency RMBS and

Core CDO s are most likely to be reduced through natural bond maturities and opportunistic sales based on underlying fundamentals and economics.

In conjunction with its risk reduction exercise, management executed targeted sales of certain assets and completed the sales of $1.5 billion of assets associated with the restructuring charge announced in the fourth quarter of 2008. The sales concentrated in certain holdings within the Company s BBB and lower corporate, CMBS, equity and consumer ABS portfolios.

Consistent with this strategy, management continued the process of reducing risk in the investment portfolio during 2009. As a result of these sales, and additional derisking steps executed over the course of 2009, the Company reduced its exposures to more volatile asset classes.

Management reduced the aggregate CMBS and non-Agency US RMBS (includes sub-prime, Alt-A, second lien, ABS CDO s, and Prime assets) portfolio holdings significantly, through maturities and paydowns and certain opportunistic sales by $2.2 billion during 2009 ($4.6 billion cumulatively since 2008), in

particular $1.4 billion in the CMBS portfolio. As well, the aggregate corporate portfolio was reduced by $1.8 billion during 2009 ($2.9 billion cumulatively since 2008).

The Company reduced its exposure to alternative investments by approximately $0.4 billion during 2009 ($1.3 billion cumulatively since 2008), and its exposure to equities by $0.3 billion during 2009 ($0.5 billion cumulatively since the beginning of 2008) in response to adverse market conditions and in regards to the risk reduction exercise ongoing within its investment portfolio.

Management further reduced interest rate

risk exposure in 2009 by shortening the duration of the investment portfolio supporting the U.S. property and casualty segment operations, excluding structured products by 0.3 years (from 3.2 to 2.9).

Cash, government and agency holdings and government backed or guaranteed holdings were increased to approximately $18.9 billion representing approximately 55.8% of the aggregate fixed income portfolio at December 31, 2009 as compared to $13.3 billion or 42% of the portfolio at December 31, 2008.

Simplify Life Investment Portfolio: Within its Life operations, management

also took measures to reduce exposure to certain more volatile asset classes.

Management reduced overall exposure to hybrid bank capital securities by $126.0 million and reinvested those proceeds in higher quality issues.

In addition, management also reduced exposure to $51.0 million of other investment grade and below investment grade securities as market opportunities presented.

While the Company seeks to reduce the overall risk within its P&C and Life investment portfolios, it will continue to attempt to balance investment returns against market and credit risks taken. Market risk may arise due to interest rate variability and exposure to foreign denominated

currencies, which the Company seeks to manage through asset/liability management, and due to the allocation to non-fixed income assets, including global equity securities and alternative investments, which the Company seeks to manage through diversification. Credit risk arises from investments in fixed income securities and is managed with aggregate and portfolio limits and by establishing minimum credit quality guidelines. The Company guidelines require a minimum Aa3/AA weighted-average rating for its fixed income portfolio.

Capital Management

Fundamental to supporting the Company s business model is its ability to underwrite business, which is largely dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Company is further downgraded, its ability to write business as well as its financial condition and/or results of operations, could be materially adversely affected. See Item 1, Business Ratings for further information regarding recent rating actions by the various rating agencies, as well as details regarding the Company s financial strength and debt ratings.

In relation to the Company s capital position, several activities occurred throughout 2008 and early 2009, including the following:

In order to fund payments under the Master Agreement described above, in August 2008, the Company raised approximately $2.8 billion of additional capital through an issuance of both ordinary shares and equity security units (the ESUs). The ESUs consist of: (i) forward purchase contracts to purchase, and the Company to issue, its ordinary shares and (ii) debt securities. For further details relating to the Master Agreement, see Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd. (Syncora).

In addition to the payments to Syncora, the Company used

the net proceeds from the offerings for general corporate purposes, and the redemption of X.L. America, Inc. s $255 million 6.58% Guaranteed Senior Notes due April 2011 (the 6.58% Notes) and capital funding of certain of the Company s subsidiaries.

Concurrent with the closing of the Master Agreement, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003 resulting in net proceeds to the Company of approximately $500.0 million in exchange for the issuance by the Company of 20,000,000 Series C Preference Ordinary Shares. See Capital Resources

below for further details relating to the Series C Preference Ordinary Shares.

In July 2008, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.19 per ordinary share beginning with the quarterly dividend paid in September 2008.

Following the settlement of the purchase contracts associated with the 7.0% ESUs in February 2009, the Company issued 11,461,080 Shares for net proceeds of approximately $743.1 million, which was used to retire the senior notes previously due February 2011 which had a fixed coupon

of 5.25% (the 2011 Senior Notes).

In February 2009, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend paid in March 2009.

On March 26, 2009, the Company completed a cash tender offer for its outstanding Series C Preference Ordinary Shares that resulted in approximately 12.7 million Series C Preference Ordinary Shares with a liquidation value of $317.3 million being purchased by the Company for approximately

$104.7 million plus accrued and unpaid dividends, combined with professional fees totaling $0.8 million. As a result, a book value gain of approximately $211.8 million was recorded in the first quarter of 2009 to ordinary shareholders.

Other capital management initiatives undertaken in 2008 and 2009 included the following:

Upon expiration of the Company s quota share reinsurance treaty with Cyrus Re which reduced the Company s catastrophe exposures, the Company, effective January 1, 2008, entered into a quota share reinsurance treaty with a newly-formed Bermuda reinsurance company, Cyrus Re II. Pursuant to the terms of the quota share reinsurance treaty, Cyrus

Re II assumed a 10% cession of certain lines of property catastrophe reinsurance and retrocession business underwritten by certain operating subsidiaries of the Company for business that incepted between January 1, 2008 and July 1, 2008. In connection with such cessions, the Company paid Cyrus Re II reinsurance premium less a ceding commission, which included a reimbursement of direct acquisition expenses incurred by the Company as well as a commission to the Company for generating the business. The quota share reinsurance treaty also provided for a profit commission payable to the Company. Cyrus Re II

was canceled and not renewed at December 31, 2008.

In the second quarter of 2008, the Company purchased additional reinsurance including several tranches of industry loss warranty contracts attaching at various levels. Such industry loss warranty contracts were short-term in nature and are not considered to be a permanent component of the Company s long-term risk management strategy. In relation to catastrophe risk management, the Company considers the loss of capital due to a single large event and the loss of capital that would occur from multiple (but potentially smaller) events in any given year. The Company

imposes a limit to catastrophe risk from any single loss in a given region/peril at a 1% exceedance probability.

73

The Company manages its limits to a catastrophe risk from a single loss in a given peril/region at a 1% exceedance probability. Tier 1 limits which include natural catastrophes and other realistic disaster scenarios are targeted at a level not to exceed 15% of tangible shareholders equity, where Tier 2 limits, which include pandemic, longevity and country risk, are established at no more than half of Tier 1 limits. These target limits are established by a combination of commercially available models, internally developed probable maximum loss estimates and the judgment of management.

Subsequent to December 31, 2009 the Company repurchased 4.4 million Series C Preference Ordinary Shares with a liquidation value of $110.8 million for approximately $94.2 million.

Proposed Redomestication to Ireland from The Cayman Islands

On January 12, 2010 the Company announced that it proposes to change the parent holding company s place of incorporation to Ireland from the Cayman Islands, with the parent holding company to be renamed XL Group plc . To effect the redomestication, a new Irish public limited company, XL Group plc, would replace XL Capital Ltd as the ultimate holding company of the XL group of companies, and the Company s ordinary shareholders would receive one ordinary share of the new Irish company in lieu of each ordinary share of the Company held by them. The Company intends to submit the proposal for redomestication, along with related proposals, to its shareholders and complete the transaction on July 1, 2010. The proposed redomestication will be subject to approval by the Company s ordinary shareholders and the Grand Court of the Cayman Islands, as well as satisfaction of other conditions. The company has operated in Ireland for most of its corporate history and is very familiar with its regulatory and legal environment. Ireland has strong international relationships as a member of the Organisation for Economic Co- Operation and Development (OECD) and the European Union, a long history of international investment, and long-established commercial relationships, trade agreements and tax treaties with the other European Union member states, the United States and other countries around the world. As a result, the Company believes Ireland offers a stable long-term legal and regulatory environment with the financial sophistication to meet the needs of XL s global business. The Company does not expect the redomestication will have any material impact on its financial results. The Company will continue to be registered with the U.S. Securities and Exchange Commission (SEC) and be subject to SEC reporting requirements. Further, the Company will continue to be subject to the mandates of the Sarbanes-Oxley Act of 2002 and the applicable corporate governance rules of the New York Stock Exchange (NYSE), and will continue to report its financial results in U.S. dollars and under U.S. generally accepted accounting principles, in addition to any reporting requirements under Irish law. The Company s shares will continue to trade on the NYSE under the ticker symbol XL .

Critical Accounting Policies and Estimates

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

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

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

As the Company earns premiums for the underwriting risks it assumes, it also establishes an estimate of the expected ultimate losses related to the premium. Loss reserves or unpaid loss and loss expenses are established due to the significant periods of time that may lapse between the occurrence, reporting and

settlement of a loss. The process of establishing reserves for unpaid property and casualty claims can be complex and is subject to considerable variability, as it requires the use of informed estimates and judgments. These estimates and judgments are based on numerous factors, and may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed or as current laws change. Loss reserves include:

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

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

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

With respect to the Company s insurance operations, the Company is notified of insured losses and records a case reserve for the estimated amount of the settlement, if any. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of legal counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. With respect to the Company s reinsurance operations, case reserves for reported claims are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the estimated ultimate cost of a loss. The uncertainty in the reserving process for reinsurers is due, in part, to the time lags inherent in reporting from the original claimant to the primary insurer to the reinsurer. As a predominantly broker market reinsurer for both excess-of-loss and proportional contracts, the Company is subject to a potential additional time lag in the receipt of information as the primary insurer reports to the broker who in turn reports to the Company. As of December 31, 2009, the Company did not have any significant backlog related to its processing of assumed reinsurance information.

Since the Company relies on information regarding paid losses, case reserves and IBNR provided by ceding companies in order to assist it in estimating its liability for unpaid losses and LAE, the Company maintains certain procedures in order to help determine the completeness and accuracy of such information. Periodically, management assesses the reporting activities of its ceding companies on the basis of qualitative and quantitative criteria. In addition to conferring with ceding companies or brokers on claims matters, the Company s claims personnel conduct periodic audits of specific claims and the overall claims procedures of its ceding companies at their offices. The Company relies on its ability to effectively monitor the claims handling and claims reserving practices of ceding companies in order to help establish the proper reinsurance premium for reinsurance agreements and to establish proper loss reserves. Disputes with ceding companies have been rare and generally have been resolved through negotiation.

As noted above, case reserves for the Company s reinsurance operations are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the Company s estimated ultimate cost of a loss. In addition to information received from ceding companies on reported claims, the Company also utilizes information on the pattern of ceding company loss reporting and loss settlements from previous catastrophic events in order to estimate the Company s ultimate liability related to catastrophic events such as hurricanes. Commercial catastrophe model analyses and zonal aggregate exposures are utilized to assess potential client loss before and after an event. Initial cedant loss reports are generally obtained shortly after a catastrophic event, with subsequent updates received as new information becomes available. The Company actively requests loss updates from cedants periodically for the first year following an event. The Company s claim settlement processes also incorporate an update to the total loss reserve at the time a claim payment is made to a ceding company.

While the reliance on loss reports from ceding companies may increase the level of uncertainty associated with the estimation of total loss reserves for property reinsurance relative to direct property insurance, there are several factors which serve to reduce the uncertainty in loss reserve estimates for property reinsurance. First, for large natural catastrophe events, aggregate limits in property catastrophe reinsurance contracts are generally fully exhausted by the loss reserve estimates. Second, as a reinsurer, the

Company has access to information from a broad cross section of the insurance industry. The Company utilizes such information in order to perform consistency checks on the data provided by ceding companies and is able to identify trends in loss reporting and settlement activity and incorporate such information in its estimate of IBNR reserves. Finally, the Company also supplements the loss information received from cedants with loss estimates developed by market share techniques and/or from third party catastrophe models applied to exposure data supplied by cedants.

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

IBNR reserves are estimated by the Company s actuaries using several standard actuarial methodologies including the loss ratio method, the loss development or chain ladder method, the Bornhuetter-Ferguson (BF) method and frequency and severity approaches. IBNR related to a specific event may be based on the Company s estimated exposure to an industry loss and may include the use of catastrophe modeling software. On a quarterly basis, IBNR reserves are reviewed by the Company s actuaries, and are adjusted as new information becomes available. Any such adjustments are accounted for as changes in estimates and are reflected in the results of operations in the period in which they are made.

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

When estimating IBNR reserves, each of the Company s insurance and reinsurance business units segregate business into exposure classes (over 150 classes are reviewed in total). Within each class, the business is further segregated by either the year in which the contract incepted (underwriting year), the year in which the claim occurred (accident year), or the year in which the claim is reported (report year). The majority of the Insurance segment is reviewed on an accident year basis. Professional lines insurance business is reviewed on a report year basis due to the claims made nature of the underlying policies. The majority of the Reinsurance segment is reviewed on an underwriting year basis.

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

Over time, as a greater number of claims are reported, actuarial estimates of IBNR are based on the BF and loss development techniques. The BF method utilizes actual loss data and the expected patterns of loss emergence, combined with an initial expectation of ultimate losses to determine an estimate of ultimate losses. This method may be appropriate when there is limited actual loss data and a relatively less stable pattern of loss emergence. The chain ladder method utilizes actual loss and expected patterns of loss emergence to determine an estimate of ultimate losses that is independent of the initial expectation of ultimate losses. This method may be appropriate when there is a relatively stable pattern of loss emergence and a relatively larger number of reported claims. Multiple estimates of ultimate losses using a variety of actuarial methods are calculated for each of the Company s (150+) classes of

business for each year of loss experience. The Company s actuaries look at each class and determine the most appropriate point estimate based on the characteristics of the particular class and other relevant factors, such as historical ultimate loss ratios, the presence of individual large losses, and known occurrences that have not yet resulted in reported

losses. Once the Company s actuaries make their determination of the most appropriate point estimate for each class, this information is aggregated and presented to management for review and approval.

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

Such estimates are not precise because, among other things, they are based on predictions of future developments and estimates of future trends in claim severity, claim frequency, and other issues. In the process of estimating IBNR reserves, provisions for economic inflation and changes in the social and legal environment are considered, but involve considerable judgment. When estimating IBNR reserves, more judgement is typically required for lines of business with longer loss emergence patterns.

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

The Company s three types of property and casualty reserve exposure with the longest tails are:

(1) high layer excess casualty insurance;

(2) casualty reinsurance; and

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

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

High layer excess casualty insurance claims typically involve claims relating to (i) a shock loss such as an explosion or transportation accident causing severe damage to persons and/or property over a short period of time, (ii) a

non-shock loss where a large number of claimants are exposed to injurious conditions over a longer period of time, such as exposure to chemicals or pharmaceuticals or (iii) a professional liability loss such as a medical malpractice claim. In each case, these claims are ultimately settled following extensive negotiations and legal proceedings. This process typically takes 5 to 15 years following the date of loss.

Reinsurance operations by their nature add further complications to the reserving process, particularly for casualty business written, in that there is an inherent lag in the timing and reporting of a loss event

from an insured or ceding company to the reinsurer. This reporting lag creates an even longer period of time between the policy inception and when a claim is finally settled. As a result, more judgment is required to establish reserves for ultimate claims in the Company s reinsurance operations.

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

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

Discontinued asbestos and long-tail environment business had been previously written by NAC Re Corp. (now known as XL Reinsurance America Inc.), prior to its acquisition by the Company. As at December 31, 2009, total gross unpaid losses and loss expenses in respect of this business represented less than 1% of unpaid losses and loss expenses.

Except for certain workers compensation liabilities (including long-term disability), the Company does not discount its unpaid losses and loss expenses. The Company utilizes tabular reserving for workers compensation unpaid losses that are considered fixed and determinable. For further discussion see the Consolidated Financial Statements.

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

The Company s net unpaid losses and loss expenses relating to the Company s operating segments at December 31, 2009 and 2008 was as follows:

(U.S. dollars in millions)	**December 31, 2009**	**December 31, 2008**
Insurance	$ 11,128	$ 11,126
Reinsurance	6,138	6,559
Net unpaid loss and loss expense reserves	$ 17,266	$ 17,685

(U.S. dollars in millions)	**Net Unpaid Losses and Loss Expenses as at December 31, 2009**		
	Case Reserves	**IBNR Reserves**	**Total Reserves**
Insurance			
Casualty professional lines.	$ 1,443	2,962	4,405
Casualty other lines	1,529	2,329	3,858
Property	340	76	416

Marine, energy, aviation, and satellite	578	492	1,070
Other specialty lines (2)	351	582	933
Other (3)	251	138	389
Structured indemnity	(8)	65	57
Total	**$ 4,484**	**6,644**	**11,128**
Reinsurance			
Casualty (4)	$ 1,723	2,321	4,044
Property catastrophe (1)	111	140	251
Other property	396	417	813
Marine, energy, aviation, and satellite	439	35	474
Other (3)	233	262	495
Structured indemnity		61	61
Total	**$ 2,902**	**3,236**	**6,138**
TOTAL	**$ 7,386**	**9,880**	**17,266**

(U.S. dollars in millions)	Net Unpaid Losses and Loss Expenses as at December 31, 2008		
	Case Reserves	**IBNR Reserves**	**Total Reserves**
Insurance			
Casualty professional lines	$ 1,558	$ 2,764	$ 4,322
Casualty other lines	1,551	2,190	3,741
Property	491	133	624
Marine, energy, aviation, and satellite	635	534	1,169
Other specialty lines (2)	341	500	841
Other (3)	233	146	379
Structured indemnity	(7)	57	50
Total	**$ 4,802**	**$ 6,324**	**$ 11,126**
Reinsurance			
Casualty (4)	$ 1,715	$ 2,427	$ 4,142
Property catastrophe (1)	157	148	305
Other property	535	427	962
Marine, energy, aviation, and satellite	443	72	515
Other (3)	256	301	557
Structured indemnity		78	78
Total	**$ 3,106**	**$ 3,453**	**$ 6,559**
TOTAL	**$ 7,908**	**$ 9,777**	**$ 17,685**

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

(2)

Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, specie, middle markets and excess and surplus lines.

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

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

As noted above, management reviews the IBNR estimates produced by the Company s actuaries and determines its best estimate of the liabilities to record in the Company s financial statements. The Company considers this single point estimate to be the mean expected outcome. Management believes that the actuarial methods utilized adequately provide for loss development.

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

While the proportion of unpaid losses and loss expenses represented by IBNR is sensitive to a number of factors, the most significant ones have historically been accelerated business growth and changes in business mix. Other factors that have affected the ratio in the past include additions to prior period reserves, catastrophic occurrences, settlement of large claims and changes in claims settlement patterns.

The ratio of IBNR to total reserves has increased in recent years due to the growth of casualty and professional business written over that period. The ratio of IBNR to total reserves is higher for more recent years business because these immature years have relatively fewer claims reported and, as a result, a higher proportion of claims reserves are based on experience in respect of incurred but not reported losses. As each prior year of business matures and claims become known, the ratio of IBNR to total reserves will typically decline, all other factors remaining constant. Since the Company has experienced premium volume growth in recent years, the ratio of IBNR to total reserves has increased because the Company s aggregate exposure has become relatively less mature. Conversely, in a situation of declining premium volume, this ratio will typically decline, all other factors remaining constant. The Company writes insurance and reinsurance business in many different lines. Typically, the ratio of IBNR to total reserves is greater for casualty (including professional) lines (which are longer-tail in nature) than for property lines due to the policy forms utilized and timing of loss reporting. In recent years, casualty lines have increased as a proportion of the Company s business when compared to property lines (which are shorter-tail in nature).

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

The following table shows the recorded estimate and the high and low ends of the range of the Company s net unpaid losses and loss expenses for each of the lines of business noted above at December 31, 2009:

(U.S. dollars in millions)	**Net Unpaid Losses and Loss Expenses Recorded as at December 31, 2009**	**Range of Net Unpaid Losses & Loss Expenses Estimated as at December 31, 2009 High**	**Range of Net Unpaid Losses & Loss Expenses Estimated as at December 31, 2009 Low**
Insurance			
Casualty professional lines	$ 4,405	$ 4,921	$ 3,913
Casualty other lines.	3,858	4,344	3,394
Property	416	462	373
Marine, energy, aviation, and satellite.	1,070	1,183	962
Other specialty lines (2)	933	1,020	848
Other (3)	389	448	333
Total (5)	$ 11,071	$ 12,071	$ 10,106
Reinsurance			
Casualty (4)	$ 4,044	$ 4,446	$ 3,674
Property catastrophe (1).	251	317	192
Other property	813	915	718
Marine, energy, aviation, and satellite.	474	537	416
Other (3)	495	567	431
Total (5)	$ 6,077	$ 6,584	$ 5,604
Structured Indemnity (5)	$ 118		
Total	$ 17,266		

(1) Property catastrophe IBNR includes event specific reserves for losses that the Company s insureds and cedants have informed it they expect to incur but have not yet had reported known claims.

(2) Other specialty lines within the Insurance segment includes: environmental, programs, equine, warranty, and excess and surplus lines.

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

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

(5) The range for the total Insurance and Reinsurance segment reserves is narrower than the sum of the ranges for the lines of business shown in the table due to diversification benefits across the lines of business. In addition, the total for each of the Insurance and Reinsurance segments does not include reserves relating to structured indemnity business as

the Company does not develop reserve ranges for this line of business.

Actual development of recorded reserves as of December 31, 2008 during 2009 was within the estimated reserve range.

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

insured by the Company, changes in the litigation environment that decrease claim awards, filings or verdicts, and/or unexpected decreases in loss inflation.

The Company s methodology in 2009 for calculating reserve ranges around its single point reserve estimate is consistent with that used in 2008. The Company modeled a statistical distribution of potential reserve outcomes over a one year run-off period for each of the approximately 35 lines of business. In doing so the Company evaluated a number of alternative models, and for each line of business the Company s actuaries selected the distribution parameters deemed to be most appropriate. Factors affecting this decision included an assessment of the model fit, availability and relevance of data and the impact of changes in business mix. The Company used the modeled statistical distribution to calculate an 80% confidence interval for the potential reserve outcomes over this one year run-off period. The high and low end points of the ranges set forth in the above table are such that there is a 10% modeled probability that the reserve will develop higher than the high point and a 10% modeled probability that the reserve will develop lower than the low point.

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

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

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

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

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Segments below for further discussion on prior year development of loss reserves.

Unpaid losses and loss expenses recoverable

The recognition of unpaid losses and loss expenses recoverable requires two key judgments. The first judgment involves the Company s estimation of the amount of gross IBNR to be ceded to reinsurers. Ceded IBNR is generally developed as part of the Company s loss reserving process and consequently, its estimation is subject to similar risks and uncertainties as the estimation of gross IBNR (see Critical Accounting Policies and Estimates Unpaid losses and

loss expenses and unpaid loss and loss expense recoverable). The second judgment involves the Company s estimate of the amount of the reinsurance recoverable balance that the Company will ultimately be unable to recover from related reinsurers due to insolvency, contractual dispute, or for other reasons. Amounts estimated to be uncollectible are reflected in

a bad debt provision that reduces the reinsurance recoverable balance and shareholders equity. Changes in the bad debt provision are reflected in net income. See Item 8, Note 13 to the Consolidated Financial Statements, Reinsurance , for further information.

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

2) Future Policy Benefit Reserves

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

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

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

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

Claims and expenses for individual policies within these annuity reinsurance contracts are projected over the lifetime of the contract to calculate a net present value of future cash flows. Assumptions for each element of the basis (mortality, expenses and interest) are determined at the issue of the contract and these assumptions are locked-in throughout the term of the contract unless a premium deficiency exists. The assumptions are best estimate assumptions plus provisions for adverse deviations on the key risk elements (i.e., mortality and interest). Provisions for adverse deviation are designed to cover reasonable deviations from the best estimate outcome of the contract. As the experience on the contracts emerges, the assumptions are reviewed. This occurs at least annually and includes both an analysis of experience and review of likely future experience. If such review would produce reserves in excess of those currently held then lock-in assumptions will be revised and a loss recognized. During the years ended December 31, 2009, 2008 and 2007, there were no adjustments to the locked-in assumptions for these annuity reinsurance contracts.

The future policy benefit reserves for these annuity portfolio reinsurance contracts amounted to $4.6 billion and $4.4 billion at December 31, 2009 and 2008 respectively. The Company holds the investment assets backing these liabilities. These investments are primarily fixed income securities with maturities that closely match the expected claims settlement profile. A 0.1% decrease in the investment yield assumption would result in approximately a $34 million increase in the value of future claims related to annuity portfolio reinsurance.

As stated above, the future policy benefit reserves include provisions for adverse deviation in excess of best estimate assumptions that amounted to approximately $232 million and $178 million at December 31, 2009 and 2008,

respectively. The future policy benefit reserves would only be increased if these provisions for adverse deviation became insufficient in the light of emerging claims experience. The present value of future claims would increase by approximately $19 million if mortality rates were to decrease by 1% in all future years, relative to the reserving assumptions.

The Company also provides reinsurance of disability income protection, for an in-force block of business. The future policy benefit reserves for these contracts amounted to approximately $94 million and $97 million at December 31, 2009 and 2008, respectively. Future policy benefit reserves include the lock-in of assumptions at inception with periodic review against experience. The liabilities relate to in-force blocks of business, comprising underlying insurance policies that provide an income if the policyholder becomes sick or disabled. The liabilities are therefore driven mainly by the rates at which policyholders become sick (where sickness is defined by the policy conditions) and by the rates at which these policyholders recover or die. A 1% increase in the incidence rate would increase the value of future claims by approximately $1.6 million, while a 1% decrease in the termination rate would increase the value of future claims by approximately $3.0 million. While no changes to the locked-in assumptions were made in 2009 or in 2008, following a review of claim termination experience in 2007, the reserving assumptions were revised, resulting in a reduction in income of $10.0 million during the year.

The Company also provides reinsurance of term assurance and critical illness policies written in the U.K., Ireland and the US. The future policy benefit reserves for these contracts amounted to approximately $229 million and $279 million at December 31, 2009 and 2008, respectively. $23 million of this reduction resulted from the sale of the U.S. life reinsurance business, XL Re Life America Inc. $124 million of this reduction resulted from the novation and recapture of a number of U.K. and Irish term assurance and critical illness treaties, which was offset by increases in reserves due to new business, ageing of the portfolio and the weakening of the U.S. dollar against the U.K. Pound Sterling and Euro in 2009. Future policy benefit reserves include the lock-in of assumptions at inception with periodic review against experience. The provisions for adverse deviation in these reserves amounted to approximately $20 million and $25 million at December 31, 2009 and 2008, respectively.

The liabilities relate to in-force blocks of business and to treaties accepting new business through 2009, comprising underlying insurance policies that provide mainly lump sum benefits if the policyholder dies or becomes sick. For term assurance, the liabilities are therefore driven by the rates of mortality and for critical illness cover, the liabilities are driven predominantly by the rates at which policyholders become sick, where sickness is defined by the treaty conditions (i.e., the morbidity rates). A 1% increase in the mortality rate relative to the reserving assumption would increase the value of future claims by approximately $2.0 million, and a 1% increase in the morbidity rate would increase the value of future claims by approximately $1.2 million.

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

The Company also provided reinsurance of a block of U.S. based term assurance, which was novated to the Company from an insurance affiliate in December 2002. The future policy benefit reserves for these contracts amounted to approximately $259 million and $254 million at December 31, 2009 and 2008, respectively. Future policy benefit reserves are established in accordance with the provisions of general authoritative guidance on accounting for insurance enterprises, including the lock-in of assumptions at inception with periodic review against experience.

The liabilities relate to in-force blocks of business, which are comprised of underlying insurance policies that provide mainly lump sum benefits if the policyholder dies. The liabilities are therefore driven by the rates of mortality, and a 1% increase in the mortality rate relative to the reserving assumption would increase the value of future claims by approximately $9 million. The liabilities are also affected by lapse experience, and a 1% decrease in lapse rates relative to the reserving assumption would increase the reserve by approximately $1.5 million. While no changes to the locked-in assumptions were made in 2009 or in 2008, following a review of mortality and lapse experience in 2007, the locked-in assumptions were revised, resulting in a reduction in income of $25.4 million during the year.

For further information see Item 8, Note 15 to the Consolidated Financial Statements, Future Policy Benefit Reserves.

3) Derivative Instruments

With regards to derivative instruments, the Company conducts activities mainly in investment-related derivative instruments, which may include credit derivatives. In addition, outside of the Company s investment portfolio, the Company previously wrote credit derivatives. The estimate of fair value for credit derivatives requires management s judgment. This is discussed below:

a) Credit Derivatives

The Company held credit derivative exposures through a limited number of contracts written as part of the Company s previous financial lines businesses, and through the Company s prior reinsurance agreements with Syncora, as described below. Following the secondary sale of Syncora common shares, the Company retained some credit derivative exposures written by Syncora and certain of its subsidiaries through reinsurance agreements that had certain derivatives exposures embedded within them. The change in value of the derivative portion of the financial guarantee reinsurance agreements the Company had with Syncora was included in Net (loss) income from operating affiliates. Following the closing of the Master Agreement during August 2008, as described in Item 8, Note 4, to the Consolidated Financial Statements Syncora Holdings Ltd. of the Company s Annual Report on Form 10-K for the year ended December 31, 2009, which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreements.

As of December 31, 2009 and 2008 the remaining credit derivative exposures outside of the Company s investment portfolio consisted of 2 and 23 contracts, respectively, written by the Company that provide credit protection on senior tranches of structured finance transactions with total insured contractual payments outstanding of $271.7 million ($244.9 million principal and $26.8 million interest), and $639.5 million ($499.5 million principal and $140.0 million of interest), weighted average contractual term to maturity of 6.0 years and 5.7 years, a total liability recorded of $18.4 million and $28.6 million, respectively, and an average rating of AA underlying obligations at each of December 31, 2009 and December 31, 2008. As of December 31, 2009, there were no reported events of default on the underlying obligations. Credit derivatives are recorded at fair value, which is determined using either models developed by the Company or third party prices and are dependent upon a number of factors, including changes in interest rates, future default rates, credit spreads, changes in credit quality, future expected recovery rates and other market factors. The change resulting from movements in credit and credit quality spreads is unrealized as the credit derivatives are not traded to realize this resultant value.

See Item 7A, Quantitative and Qualitative Disclosures About Market Risk for sensitivity analysis and Item 8, Note 17 to the Consolidated Financial Statements, Derivative Instruments.

4) Other Than Temporary Declines in Investments (OTTI)

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

As mentioned above, the Company considers whether it has an intent to sell a debt security before the value recovers as part of the process of evaluating whether a security s unrealized loss represents an other than temporary decline.

However, this factor on its own does not dictate whether or not the Company recognizes an impairment charge. The Company s belief that it will not be more likely than not required to sell securities is supported by positive and sufficient cash flow from its operations and from maturities within its investment portfolio in order to meet its claims payment obligations arising from its underwriting operations without selling such investments.

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

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

The Company reviews, on a quarterly basis, the entirety of its investment portfolio in a gross unrealized loss position to assess whether it believes a credit loss, relative to the current amortized cost of the security, exists. The Company utilizes specific screening criteria to identify securities at risk for a credit loss, and if any of these conditions exists, subject the individual security to a detailed review to determine if a credit loss exists. The screening criteria used by the Company include the absolute degree of impairment of the security as a percentage of amortized cost, the credit rating of the security, the market yield-to-maturity of the security, and any securities that have previously been identified as impaired due to credit losses and thus are at elevated risk of further impairments. In addition, on a quarterly basis, the Company reviews any current market developments and identifies if there are new issues that may adversely impact the Company s investment portfolio, and reviews any impacted holdings.

Credit loss methodology structured credit

Credit loss on structured credit securities is determined through a comparison of the security s discounted cash flow to the amortized cost of the security. To the extent that the discounted cash flow is estimated to be lower than the amortized cost of the security, the security is impaired to the discounted cash flow value of all security cash flows, including both coupon and principal repayment, discounted at the original security coupon, or for certain securities, the rate which represents the current yield of the securities.

The Company, in conjunction with its third-party investment management service providers, makes significant assumptions in its impairment analysis with regards to the following specific asset classes. These assumptions are as at December 31, 2009 and are subject to changes in both economic fundamentals and management s estimates in future periods.

(1) Non-Agency RMBS

The Company utilizes assumptions specific to its individual holdings and accordingly individual assumptions will differ on a security by security basis depending on the quality of the collateral and the performance of the underlying pools. In general, the Company projects that future defaults will develop based on the performance of the underlying collateral, measured by the number of loans currently in arrears.

Loans > 30 days in arrears	50% will ultimately default
Loans 30-60 days in arrears	60% will ultimately default
Loans 30-90 days in arrears	75% will ultimately default
Loans in foreclosure	100% default rate

Bank held	75% default rate

The Company estimates that the cumulative losses on the mortgage structures it owns will vary depending on the vintage and collateral of the underlying loans in the holdings. Cumulative deal loss expectations are projected based on the number of loans expected to take a loss and the severity of loss

upon default. Loan loss severities depend on the borrower, geographic location and loan to value characteristics of the underlying collateral. The Company estimates that loss severities will range from 40-60% for sub prime and Alt-A loans and 10-20% for Prime loans. These cumulative losses results are then compared to the level of subordination within the Company s holdings to measure if impairment exists.

	Vintage			
	2007	**2006**	**2005**	**2004**
2nd Lien	75 %	55 %	30 %	15 %
Alt-A non option ARM	30 %	25 %	14 %	6 %
Alt-A Option ARM	39 %	33 %	19 %	10 %
Prime	12 %	10 %	6 %	2 %
Subprime.	47 %	40 %	23 %	12 %

(2) Core CDOs

The Company utilizes a scenario based approach to reviewing the majority of its CDO portfolio, which consists primarily of collateralized loan obligations. The five significant scenarios utilized in the model consist of:

- 2 base cases assuming asset defaults are equivalent to either the expected corporate default probabilities, or the cumulative default rates for similar time frames from the period of 1983 to 2008

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

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

rate

The weighted scenario of the five scenarios above is used for the determination of a potential impairment. If losses are forecast to be below the subordination level for the tranche of holding held by the Company, the security is determined not to be impaired. The weighting between these scenarios varies over time depending on market conditions, but the weighting used for the year-end 2009 evaluation consisted of 45% to the base cases noted above, 0% to the optimistic case, 25% to the pessimistic case, and 30% to the market implied case. For the non-CLO portion of the core CDO portfolio, the Company utilizes specific default scenarios related to the particular underlying assets.

(3) Other structured credit assets classes

The remainder of the gross unrealized losses related to the Company s structured credit portfolio are concentrated in the following significant asset classes:

¡ Agency RMBS, which represent AAA rated holdings backed by either the explicit or implicit guarantee of the U.S. government. The Company considers the risk of loss in these asset classes remote and linked to the overall credit-worthiness of the U.S. government.

¡ CMBS, which are dominated by AAA rated holdings which generally have high levels of credit subordination, are highly diversified and despite recent volatility related to credit spreads, are priced reasonably close to par. The Company reviews these holdings on an individual

security basis to the extent they meet the screens noted above, but generally does not believe these securities to have a high risk of credit loss given their high subordination levels.

- Other ABS, which is a mix of mostly investment grade credit card, auto and non US ABS structures have risk and performance characteristics unrelated to the US housing market. In cases where these sectors have met Company screens the individual securities are evaluated based on fundamental credit analysis of the underlying structure. Impairments in this category have been limited primarily to securities with inherent extension risk as opposed to risk of default or loss of cash flow.

Credit loss analysis corporates

Credit losses on corporate securities are generally determined on an individual security basis. The Company reviews the circumstances and conditions associated with its credit issuers, including considering credit rating and forecast operating and financing activities of the issuer, and will make a determination as to whether it believes the issuer is

likely to fully meet its contractual principal and interest obligations. To

the extent the Company does not believe the issuers will meet these obligations, it recognizes a credit loss as the difference between amortized cost and the estimated present value of cash flows expected to be received. The Company reviews the ability to pay at the lowest tier (i.e. most subordinated) of the capital structure at which it holds securities, and to the extent it is satisfied in the performance of the lower tier, concludes that any more senior tiers are also likely to meet obligations.

The company evaluates separately credit losses associated with below investment grade hybrid securities, representing Tier One and Upper Tier Two perpetual preferred securities that have been rated below investment grade by at least one major rating agency. The Company completes a debt-based impairment review, including an analysis of whether these securities are expected to meet their obligations, and whether the issuer has the ability to call these obligations at their call date. In addition, the Company uses an equity-impairment model to evaluate these holdings, including assessing the expected recovery period of the securities, the length of time these securities have been rated below investment grade, and whether alternative ratings were available that indicates these securities remain investment grade, or only slightly below investment grade. In addition, the Company evaluates the likelihood of how various governments have treated the perpetual preferred shareholdings in the event of government intervention in these institutions operations or management s decision to defer calls or coupons.

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

5) Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company had capitalized net operating tax losses of $314.0 million and $317.3 million against which a valuation allowance of $220.7 million and $224.3 million at December 31, 2009 and 2008, respectively, was established. The Company had capitalized realized and unrealized capital losses of approximately $262.4 million and $32.3 million, respectively, against which a valuation allowance of approximately $294.7 million at December 31, 2009 was established. Included within the capitalized realized losses are $168.7 million of losses arising from the sale of investments to a group company, against which a valuation allowance of $168.7 million has been established. The deferral of benefits from tax losses is evaluated based upon management s estimates of the future profitability of the Company s taxable entities based on current forecasts, the character of income and the period for which losses may be carried forward. A valuation allowance may have to be established for any portion of a deferred tax asset that management believes will not be realized. Should the future income of these entities fall below expectations, a further valuation allowance would have to be established, which could be significant. In addition, if any further losses are generated by these entities, these losses may not be tax affected.

For further information see Other Revenues and Expenses and Item 8, Note 25 to the Consolidated Financial Statements, Taxation.

6) Goodwill and Other Intangible Assets

The Company has recorded goodwill in connection with various acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with FASB issued final authoritative guidance on goodwill and other intangible assets, the Company tests goodwill for potential impairment

annually as of June 30 and between annual tests if an event occurs or circumstances change that may indicate that potential exists for the fair value of a reporting unit to be reduced to a level below its carrying amount. The Company tests for impairment at the reporting unit level in accordance with the authoritative guidance on intangibles and goodwill. For the reinsurance segment, a

reporting unit is one level below the business segment, while for insurance, the segment is also the reporting unit. The first step is to identify potential impairment by comparing the estimated fair value of a reporting unit to the estimated book value, including goodwill. The fair value of each reporting unit is derived based upon valuation techniques and assumptions the Company believes market participants would use to value the business and this is then compared to the book value of the business. The Company derives the net book value of its reporting units by estimating the amount of shareholders equity required to support the activities of each reporting unit. The estimated fair values of the reporting units are generally determined utilizing methodologies that incorporate price-to-net-tangible-book and price-to-earnings multiples of certain comparable companies, from an operational and economic standpoint. If such estimated fair value, combined with an estimate of an appropriate control premium, indicates a close call or potential impairment, further analysis using discounted cash flows is performed. A control premium represents the value an investor would pay above minority interest transaction prices in order to obtain a controlling interest in the respective company. If the estimated fair value exceeds the book value, goodwill at the reporting unit level is not deemed to be impaired. If the book value exceeds the estimated fair value, the second step of the process is performed to measure the amount of impairment.

For further detailed information, see Item 8, Note 7 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets.

7) Reinsurance Premium Estimates

The Company writes business on both an excess of loss and proportional basis. In the case of excess of loss contracts, the subject written premium is generally outlined within the treaty and the Company receives a minimum and/or deposit premium on a quarterly basis which is normally followed by an adjustment premium based on the ultimate subject premium for the contract. The Company estimates the premium written on the basis of the expected subject premium and regularly reviews this against actual quarterly statements to revise the estimate based on the information provided by the cedant.

On proportional contracts, written premiums are estimated to expected ultimate premiums based on information provided by the ceding companies. An estimate of premium is recorded at the inception of the contract. The ceding company s premium estimate may be adjusted based on their history of providing accurate premium estimates. When the actual premium is reported by the ceding company, normally on a quarterly basis, it may be materially higher or lower than the estimate. Adjustments arising from the reporting of actual premium by the ceding companies are recorded in the period in which they are determined.

Written premiums on excess of loss contracts are earned in accordance with the loss occurring period defined within the treaty, normally 12 months following inception of the contract. Written premiums on proportional contracts are earned over the risk periods of the underlying policies issued and renewed, normally 24 months. For both excess of loss and proportional contracts, the earned premium is recognized ratably over the earning period, namely 12 - 24 months. The portion of the premium related to the unexpired portion of the policy at the end of any reporting period is reflected in unearned premiums.

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

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

At December 31, 2009 and 2008, the amount of premiums receivable related to the Company s reinsurance operations amounted to $1.8 billion and $1.7 billion, respectively.

A significant portion of amounts included as premiums receivable, which represent estimated premiums written, net of commissions, are not currently due based on the terms of the underlying contracts. Management reviews the premiums receivable balance at least quarterly and provides a provision for amounts deemed to be uncollectible. The Company recorded a provision for uncollectible premiums

receivable related to its reinsurance operations at December 31, 2009 and 2008 of $4.8 million and $19.0 million, respectively.

The amount of proportional and excess of loss reinsurance gross premiums written and gross acquisition expenses recognized by the Company s reinsurance operations for each line of business for the years ended December 31, 2009, 2008 and 2007 was as follows:

	December 31, 2009		December 31, 2008		December 31, 2007	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**
Proportional Contracts:						
Casualty other lines	44,924	12,075	47,791	16,777	133,444	52,062
Casualty professional lines	41,195	12,652	62,268	20,772	47,361	23,413
Other property	703,219	164,094	745,244	148,066	739,130	201,170
Marine, energy, aviation and satellite	34,636	8,116	32,935	14,101	47,359	14,981
Other (1)	144,116	40,628	197,418	25,339	222,374	37,177
Total Proportional contracts	$ 968,090	$ 237,565	$ 1,085,656	$ 225,055	$ 1,189,668	$ 328,803

	December 31, 2009		December 31, 2008		December 31, 2007	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**
Excess of loss Contracts:						
Property catastrophe	$ 357,267	$ 33,074	$ 401,740	$ 30,688	$ 475,540	$ 46,621
Casualty other lines	173,853	34,383	308,932	50,565	409,807	69,133
	129,733	26,241	151,251	29,696	208,919	45,476

Casualty professional lines												
Other property		159,091		12,892		202,655		18,096		231,066		21,724
Marine, energy, aviation and satellite		54,463		5,429		86,658		9,191		103,189		11,121
Other (1)		11,978		2,642		22,914		8,792		17,044		2,956
Structured Indemnity		4,948		2,566		671		2,699		28,261		374
Total Excess of loss contracts	$	891,333	$	117,227	$	1,174,821	$	149,727	$	1,473,826	$	197,405

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

Segments

Following a streamlining of the Company s operating segments in the first quarter of 2009, the Company is organized into three operating segments: Insurance, Reinsurance and Life Operations in addition to a Corporate segment that includes the general investment and financing operations of the Company.

The Company evaluates the performance of both the Insurance and Reinsurance segments based on underwriting profit and contribution from its Life Operations segment. Other items of revenue and expenditure of the Company are not evaluated at the segment level for reporting purposes. In addition, the Company does not allocate investment assets by segment for its 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 in Corporate are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these segments. See Item 8, Note 6 Segment Information for a reconciliation of segment data to the Company s consolidated financial statements.

Income Statement Analysis

Insurance

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

(U.S. dollars in thousands)	2009	% Change 2009 vs 2008	2008	% Change 2008 vs 2007	2007
Gross premiums written	$ 4,251,888	(19.9)%	$ 5,308,914	(2.3)%	$ 5,434,266
Net premiums written	3,273,380	(17.9)%	3,984,826	(4.8)%	4,186,855
Net premiums earned	3,559,793	(10.9)%	3,997,045	(2.9)%	4,116,588
Net losses and loss expenses.	2,399,747	(12.2)%	2,733,344	5.3 %	2,594,812
Acquisition costs	429,170	(7.7)%	465,044	(3.9)%	484,014
Operating expenses	689,131	0.3 %	687,129	0.6 %	683,108
Underwriting profit	$ 41,745	(62.6)%	$ 111,528	(68.6)%	$ 354,654
Net results structured products	$ 16,660	NM *	$ (14,713)	NM *	$ (2,480)
Net fee income and other	(14,241)	NM *	(5,072)	NM *	11,812

* NM Not Meaningful

Gross and net premiums written decreased by 19.9% and 17.9%, respectively, during the year ended December 31, 2009 as compared to the same period in 2008. The decrease in gross premiums was seen across virtually all lines of business due to a combination of factors including, strategic decisions to exit specific lines of business, poor market and economic conditions, impacts of the S&P downgrade in December 2008 which directly affected retention early in the year and new business opportunities, decreases in insured values, fewer long term agreements which are being renewed on a single year basis and unfavorable foreign exchange rate impacts. Offsetting the overall decrease was growth in professional lines and new business from the Company s middle market strategy. The renewal pricing has steadily improved throughout 2009 over most lines of business, with an overall modest increase of 1% across the

entire book. Retention rates have largely returned to historic levels. The decrease in net premiums written was due to the decrease in gross premiums written noted above partially offset by a reduction in ceded premiums as compared to the same period in 2008. The relative decrease in ceded premium was driven by a shift from proportional to excess of loss treaties partially offset with increased rates in property and environmental lines.

Gross premiums written decreased by 2.3% during the year ended December 31, 2008 compared with 2007, primarily as a result of continued decreases in premium rates as market conditions continued to soften, a reduction in long-term agreements in late 2008, selective non-renewals and to a lesser extent, lost business opportunities associated with rating agency downgrades that occurred in 2008. Such decreases in gross premiums written were primarily within casualty and professional lines of business as well as certain specialty lines including environmental, aerospace and marine portfolios. Partially offsetting these decreases was growth in certain property lines, particularly in the construction book in Europe, as well as excess and surplus and middle market lines and favorable foreign exchange rate movements totaling $108.4 million. Net premiums written decreased by 4.8% during the year ended December 31, 2008 as compared to 2007 primarily as a result of the decrease in gross premiums written described above coupled with an increase in ceded premiums written associated with growth in certain property lines, change in the mix of business including an increase in long-term agreements with higher cession ratios, the impact from the purchase of an adverse development cover associated with a Company owned Lloyd s syndicate and unfavorable foreign exchange rate impacts of $29.6 million.

Net premiums earned decreased by 10.9% in 2009 as compared to 2008 and by 2.9% in 2008 as compared to 2007. These decreases were primarily a reflection of the overall reduction of net premiums written over the last 12 to 24 months.

The following table presents the ratios for the Insurance segment for each of the last three years ended December 31:

	2009	2008	2007
Loss and loss expense ratio	67.4 %	68.4 %	63.0 %
Underwriting expense ratio	31.4 %	28.8 %	28.4 %
Combined ratio	98.8 %	97.2 %	91.4 %

The loss and loss expense ratio noted above includes net losses incurred for both the reported year and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year.

The following table summarizes the net (favorable) adverse prior year development by line of business relating to the Insurance segment for the last three years ended December 31:

(U.S. dollars in millions)	2009	2008	2007
Property	$ (50.7)	$ (106.0)	$ (95.0)
Casualty and Professional	(41.0)	(214.1)	(139.1)
Specialty and Other	28.8	9.6	76.0
Structured Indemnity		5.0	
Total	$ (62.9)	$ (305.5)	$ (158.1)
Loss and loss expense ratio excluding prior year development	69.2 %	76.0 %	66.9 %

In addition, the following tables present the prior year (favorable) adverse development of the Company s gross and net loss and loss expense reserves within the Insurance segment for the last three years ended December 31:

Gross:

(U.S. dollars in millions)	2009	2008	2007
Unpaid losses and loss expense reserves at the beginning of the year	$ 14,373	$ 14,856	$ 14,528
Net (favorable) adverse development of those reserves during the year	(45)	(610)	(178)
Unpaid losses and loss expense reserves re-estimated one year later	$ 14,328	$ 14,246	$ 14,350

Net:

(U.S. dollars in millions)	**2009**	**2008**	**2007**
Unpaid losses and loss expense reserves at the beginning of the year	$ 11,126	$ 11,138	$ 10,608
Net (favorable) adverse development of those reserves during the year	(63)	(305)	(158)
Unpaid losses and loss expense reserves re-estimated one year later	$ 11,063	$ 10,833	$ 10,450

Excluding prior year development, the loss ratio for the year ended December 31, 2009 decreased by 6.8 loss percentage points as compared 2008 due primarily to lower levels of large property risk and catastrophe losses occurring in 2009 combined with the impact of anticipated sub prime and credit related losses in 2008. These decreases were partially offset by increased current year loss ratios in certain casualty lines including US risk management. The remainder of the benefit was attributable to better loss experience on the excess and surplus lines of business as compared to 2008.

Net favorable prior year reserve development of $62.9 million for the year ended December 31, 2009 was mainly attributable to the following:

For property lines, net prior year development during the year was $50.7 million favorable largely as a result of a lower than expected level of attritional non-catastrophe claims across older accident years as well as reserve releases in the 2008 European general property portfolio due to lower than expected reported loss activity. Prior year catastrophe loss estimates remained stable.

For casualty lines, net prior year development during the year was $29.4 million unfavorable due to reserve strengthening on the European excess lines for accident years 2000-2004, and the recognition of potential excess casualty exposures on the discontinued casualty lines. Offsetting this reserve

strengthening were reserve releases from the casualty primary business due to better than expected loss activity from the more recent accident years, and US risk management lines due to greater reliance on actual loss experience over initial target loss ratios.

For professional lines, net prior year development was $70.4 million favorable, primarily as a result of lower incurred activity than expected based on the Company s prior valuation in global D&O lines, primarily for underwriting years 2002 to 2006. This release was partially offset by strengthening of global E&O reserves primarily in the 2000 and 2001 years due to large claims. In

addition, there was a reallocation of subprime and related credit crisis reserves from the 2007 to 2008 report year to better reflect the indications of our latest exposure-based reserve analysis for these years.

For specialty and other lines, net prior year adverse development was $28.8 million due in part to a deterioration in environmental lines but mainly from discontinued specialty lines, specifically, for surety to reflect our assessment of the potential impact of the economic downturn on ultimate loss activity, the Lloyd s Accident & Health book where incurred development was higher than implied by the Company s selected benchmarks and the resulting lengthening of

loss reporting patterns, and political risks where there was reserve strengthening on a specific potential claim. Offsetting the adverse development was favorable reserve development on the aerospace and marine and offshore energy lines due to better than expected activity and an update of development assumptions to reflect recent historical experience.

Excluding prior year development, the loss ratio for the year ended December 31, 2008 increased by 9.1 loss percentage points as compared to 2007 with 2.6 points of the loss ratio increase attributable to a higher level of catastrophe losses in the 2008 year, including the impacts of Hurricanes Ike and Gustav, which resulted in net incurred losses in the Company s Insurance segment of $54.0 million and $10.4 million, respectively, net of reinsurance recoverables and reinstatement premiums. The remainder of the increase in loss ratio was attributable to an increase in loss activity in the property line of business, loss activity anticipated for professional lines related to sub-prime and related credit events, premium adjustments booked in the third and fourth quarters as well as the softening rate environment impacting most lines of business.

Net favorable prior year development of $305.5 million for the year ended December 31, 2008 was mainly attributable to the following:

For property and casualty lines, reserve releases in certain casualty lines primarily in 2003 to 2006 accident years due to lower than expected reported loss activity and

favorable reserve development in global property lines of business as a result of favorable claim development. In addition, net reserve releases resulted from an agreement with AXA/Winterthur of approximately $80.9 million in the fourth quarter of 2008 in regards to certain reinsurance recoverable balances relating to casualty lines and, to a lesser extent, certain property lines of business.

For professional lines, reserve releases in the 2003 to 2006 accident years were largely offset by strengthening of reserves in the 2007 year.

For specialty lines, modest reserve strengthening within specialty lines, primarily in the environmental lines of business, as well as strengthening associated with certain structured indemnity

contracts.

The increase in the underwriting expense ratio in the year ended December 31, 2009, compared to 2008, was due to an increase in the acquisition expense ratio of 0.5 points (12.1% as compared to 11.6%) combined with an increase in the operating expense ratio of 2.1 points (19.3% as compared to 17.2%). The increase in the acquisition expense ratio was primarily as a result of changes in the mix of business given the decreases in property and casualty lines which carry the lowest levels of acquisition cost. The increase in the operating expense ratio is attributable to the lower level of earned premium combined with the costs associated with the Company s expense reduction initiatives announced in the third quarter of 2008 and first quarter of 2009 including changes to the Company s previously communicated operational transformation program and the insurance segments recently announced internal business realignment.

The increase in the underwriting expense ratio in the year ended December 31, 2008, compared to 2007, was due to an increase in the operating expense ratio of 0.6 points (17.2% as compared to 16.6%)

and partially offset by a decrease in the acquisition expense ratio of 0.2 points (11.6% as compared to 11.8%). The increase in the operating expense ratio was mainly as a result of a higher headcount, which increased compensation, increases in professional fees and the impact of employee termination benefits recorded in the latter half of 2008, against lower net premiums earned. The increase in headcount and professional fees both supported new segment initiatives as well as the formation of XL GAPS in late 2007. Offsetting these increases in 2008 were decreases in performance related compensation. The acquisition expense ratio decreased mainly due to a reduction in foreign excise taxes as a result of a decrease in the cession percentage of an internal quota share from 75% to 50%, lower guarantee fund assessments and the impact of changes in the mix of business written.

Fee income decreased in 2009 as compared to 2008 mainly as a result of lower engineering fee income associated with the Company s loss prevention consulting services business coupled with other expenses in professional lines due to the cost of the National Indemnity facility. Fee income increased in 2008 as compared to 2007 mainly as a result of higher engineering fee revenue associated with XL GAPS.

Net results from structured insurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these products for the year ended December 31, 2009 increased compared to the same period in 2008 mainly due to an accretion adjustment based on changes in expected cashflows of a structured indemnity contract recorded in 2008, lower operating expenses of this run-off line of business and favorable development in the liability interest rate hedges in place, partially offset by lower net investment income as a result of lower yields combined with a lower average investment asset base. Results from these contracts for the year ended December 31, 2008 decreased compared to the same period in 2007 mainly due to lower net investment income and higher operating expenses, partially offset by lower interest expense. Net investment income decreased as a result of lower yields earned on investment income while operating expenses increased as a result of costs recorded in the latter half of 2008 associated with employee termination benefits relating to the closure of the XLFS business unit as noted above. Interest expense decreased mainly due to negotiated cancellation of certain contracts in 2008 was partially offset by an accretion adjustment recorded during the same period, based on changes in expected cash flows on a structured indemnity contract.

Reinsurance

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

(U.S. dollars in thousands)		**2009**	**% Change 2009 vs 2008**		**2008**	**% Change 2008 vs 2007**		**2007**
Gross premiums written	$	1,859,423	(17.7)%	$	2,260,477	(15.1)%	$	2,663,494
Net premiums written		1,470,332	(16.1)%		1,753,467	(16.9)%		2,110,865
Net premiums earned		1,591,946	(20.1)%		1,993,206	(13.4)%		2,302,039
Net losses and loss expenses		769,090	(37.4)%		1,229,554	(1.2)%		1,244,764
Acquisition costs		346,699	(9.5)%		383,136	(20.5)%		482,024
Operating expenses		190,596	0.8 %		189,027	(8.2)%		205,966
Underwriting	$	285,561	49.1 %	$	191,489	(48.1)%	$	369,285

profit					
Net results structured products	26,374	2.6 %	25,694	0.7 %	25,520
Fee income and other	6,209	(32.9)%	9,260	NM *	1,698

* NM Not meaningful

Gross and net premiums written decreased by 17.7% and 16.1%, respectively, in the year ended December 31, 2009 as compared to the same period in 2008. The decrease in gross premiums written is mainly a result of the Company s focus on short-tail lines, certain lost renewals and reduced business as a result of the S&P ratings downgrade in December 2008, strategic decisions to exit certain lines of business and unfavorable foreign exchange rate movements. Partially offsetting these decreases were rate increases in certain lines of business including property catastrophe, marine and aviation lines. The decrease in net premiums written was due to the decrease in gross premiums written noted above partially offset by a reduction in ceded premiums as compared to the same period in 2008. This decrease was mainly as a result of the cancellation and non-renewal of Cyrus Re II at December 31, 2008 and a reduction in the ceded premium on the US agricultural program. Cyrus Re II previously assumed a 10% cession of certain lines of

property catastrophe reinsurance and retrocession business underwritten by certain operating subsidiaries of the Company.

Gross and net premiums written decreased by 15.1% and 16.9%, respectively, in the year ended December 31, 2008 as compared to the same period in 2007. These decreases resulted from the Company declining business due to competitive pressures continuing to drive certain rates below the Company s acceptable underwriting return levels together with increased client retentions. Partially offsetting these decreases in gross premiums written were favorable foreign exchange rate movements of $55.0 million and increases of $118.4 million associated with a U.S. agricultural program whose rates are tied to commodity prices, which have increased in 2008. Ceded premiums written decreased mainly as a result of the impact of a reduction in property catastrophe cessions to Cyrus Re II of 10% in 2008 as compared to a 35% cession to Cyrus Re throughout 2007, partially offset by ceded premiums totaling $23.3 million associated with the purchase of additional catastrophe loss protection in the form of industry loss warranty covers. However, the overall ceded ratio increased mainly due to lower net retention in 2008 as compared to 2007, mainly due to higher cession ratios associated with the U.S. agricultural program noted above, causing net premiums written to decrease at a higher percentage than gross premiums written.

Net premiums earned decreased by 20.1% in 2009 as compared to 2008 and by 13.4% in 2008 as compared to 2007. These decreases were primarily a reflection of the overall reduction of net premiums written over the last three years.

The following table presents the ratios for the Reinsurance segment for the last three years ended December 31:

	2009	2008	2007
Loss and loss expense ratio	48.3 %	61.7 %	54.1 %
Underwriting expense ratio	33.8 %	28.7 %	29.8 %
Combined ratio	82.1 %	90.4 %	83.9 %

The loss and loss expense ratio includes net losses incurred in the reported year and any favorable or adverse prior year development of loss reserves held at the beginning of the year.

The following table summarizes the net (favorable) adverse prior year development by line of business relating to the Reinsurance segment for the last three years ended December 31:

(U.S. dollars in millions)	2009	2008	2007
Property and other short-tail lines	$ (142.5)	$ (138.4)	$ (188.7)
Casualty and other	(80.3)	(166.8)	(87.4)
Structured Indemnity	1.0		8.8
Total	$ (221.8)	$ (305.2)	$ (267.3)
Loss and loss expense ratio excluding prior year development	62.2 %	77.0 %	65.7 %

In addition, the following tables present the prior year (favorable) adverse development of the Company s gross and net loss and loss expense reserves within the Reinsurance segment for the last three years ended December 31:

Gross loss and loss expense reserves:

(U.S. dollars in millions)	**2009**	**2008**	**2007**
Unpaid losses and loss expense reserves at the beginning of the year	$ 7,278	$ 8,001	$ 8,193
Net (favorable) adverse development of those reserves during the year	(257)	(444)	(260)
Unpaid losses and loss expense reserves re-estimated one year later	$ 7,021	$ 7,557	$ 7,933

Net loss and loss expense reserves:

(U.S. dollars in millions)		2009		2008		2007
Unpaid losses and loss expense reserves at the beginning of the year	$	6,559	$	7,053	$	7,138
Net (favorable) adverse development of those reserves during the year		(222)		(305)		(267)
Unpaid losses and loss expense reserves re-estimated one year later	$	6,337	$	6,748	$	6,871

Excluding prior year development, the loss ratio for the year ended December 31, 2009 decreased by 14.8 loss percentage points as compared to an increase in the same period in 2008 with 11.3 loss ratio points attributable primarily to the impact of catastrophe losses occurring in 2008 compared to 2009. Losses related to 2009 catastrophes included Hailstorm Wolfgang, Japan Earthquake, Windstorm Klaus, Typhoon Ketsana, Asian Earthquake/Tsunami and Australian Wildfires. 2008 catastrophes included losses related to Hurricanes Ike & Gustav, Midwest Floods, Windstorm Emma, China Snowstorm, Australian Floods, Greece Earthquake, China Earthquakes and Hailstorm Detmold.

Net favorable prior year reserve development for the Reinsurance segment of $221.8 million for the year ended December 31, 2009 was mainly attributable to the following:

Net favorable prior year development of $142.5 million for the short-tailed lines in the year and details of these by specific lines are as follows:

$46.2 million in favorable property catastrophe development due to lower than expected loss development, particularly

on the 2008 underwriting year and $12.3 million in reserve reductions for several 2005 natural catastrophe events including European floods, windstorm Erwin and California wildfires.

$88.8 million in favorable development due primarily to lower than expected claim emergence from underwriting years 2005-2008 in Latin America ($27.5 million), Europe ($21.6 million), Bermuda ($20.6 million) and US ($13.8 million).

$7.5 million in marine and aviation lines due to lower than expected claim emergence in

the European marine book for underwriting years 2007 and 2008 offset by minimal net reserve increases on the aviation book.

Net favorable prior year development of $79.3 million for the long-tailed lines in the year and details of these by specific lines are as follows:

$21.0 million in favorable casualty development related primarily to the European General Liability and UK Motor portfolios in underwriting years 2004-2007.

$40.7 million in favorable professional development due primarily to US exposures for underwriting

years 2002 and prior in addition to professional indemnity exposures for European underwriting years 2006 and prior.

$17.6 million in favorable development in non-casualty long tail lines largely in Latin America due to favorable emergence from surety exposures.

Excluding prior year development, the loss ratio for the year ended December 31, 2008 increased by 11.3 loss percentage points as compared to the same period in 2007 with 7.7 points attributable to an increase in catastrophe losses occurring during 2008 (12.0 points in 2008 versus 4.3 points in 2007), mainly as a result of the impacts of Hurricanes Ike and Gustav, which resulted in net incurred losses in the Company s Reinsurance segment of $155.9 million and $12.1 million, respectively, net of reinsurance recoverables and reinstatement premiums. The remaining increase of 3.6 loss ratio points was attributable to the softening rate environment, higher attritional property losses and higher anticipated loss activity in the professional and trade credit portfolios.

For the year ended December 31, 2008, net favorable prior year development totaled $305.2 million as explained below.

Net favorable prior year development of $138.4 million for the property and other short-tailed lines development were attributable to most business units

globally.

- Net favorable prior year development of $166.8 million for the casualty and other lines in both European and U.S. casualty and professional portfolios as well as reserve releases associated with the reinsurance-to-close relating to the 2005 year of account on certain Lloyd s sourced business.

The increase in the underwriting expense ratio in the year ended December 31, 2009, as compared to 2008, was due to an increase in both operating expense and acquisition expense ratios to 12.0% and 21.8%, respectively, as compared with 9.5% and 19.2%, in 2008. Despite the marginal increase in operating expenses, there was a disproportionately larger increase in the operating expense ratio due to a greater percentage decrease in net premiums earned. The increase in the acquisition expense ratio relates to changes in the mix of business, increased commissions associated with the U.S. agricultural program as well as increased profit related commissions associated with certain Bermuda-based property catastrophe business.

The decrease in the underwriting expense ratio in the year ended December 31, 2008, as compared with the same period in 2007, was due to a decrease in the acquisition expense ratio of 1.7 points (19.2% compared to 20.9%) and was partially offset by an increase in the operating expense ratio of 0.6 points (9.5% compared to 8.9%). The decrease in the acquisition expense ratio was primarily due to a favorable variance in performance-related commissions in 2008 as compared to 2007. Although operating expenses were lower in the year ended December 31, 2008 as compared to the same period in 2007, the lower level of net premiums earned as noted above caused an increase in the operating expense ratio. The decrease in operating expenses was mainly as a result of a bad debt provision and higher performance related compensation expenses both recorded in 2007 and was partially offset by the impact in 2008 of costs associated with the Company s restructuring activities as well as administrative expenses associated with the expansion of the Company s reinsurance operations in Brazil.

Fee income decreased by $3.1 million during 2009 as compared to 2008 mainly as a result of fees associated with capacity utilization with certain Lloyd s syndicates in 2008 that were not repeated in 2009. Fee income increased by $7.6 million during 2008 as compared to 2007 mainly as a result of fees associated with capacity utilization with certain Lloyd s syndicates.

Net results from structured reinsurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Net results from these products for the year ended December 31, 2009 increased slightly compared to the same period in 2008 mainly due to lower operating expenses of this run-off line of business and favorable development in the liability interest rate hedges in place partially offset by lower net investment income as a result of lower yields combined with a lower average investment asset base. Results from these products for the year ended December 31, 2008 increased slightly compared to the same period in 2007 mainly due to lower interest expenses associated with a higher accretion rate recorded in 2007 on certain workers compensation coverage partially offset by lower net investment income from lower yields earned on invested assets in 2008 as compared to 2007 combined with the impact of a lower average investment asset base.

Life Operations

As noted above, the Company completed a strategic review of its Life reinsurance business in early 2009. This resulted in the Company selling the renewal rights to a portion of its European life, accident and health reinsurance business, a relatively small block of business, in December 2008, as well as ceasing to write new U.K. and Irish life and annuity business from March 2009. In July 2009, the Company entered into an agreement to sell its U.S. life reinsurance business and this transaction concluded during the fourth quarter of 2009. Business previously written by the Life Operations segment was primarily European life reinsurance and included term assurances, group life, critical illness cover, immediate annuities, disability income cover, and short-term life, accident and health business.

The following table summarizes the contribution from the life segment:

(U.S. dollars in thousands)		**2009**	**% Change 2009 vs 2008**		**2008**	**% Change 2008 vs 2007**		**2007**
Gross premiums written	$	576,162	(16.6)%	$	690,915	(7.0)%	$	743,220
Net premiums written		532,852	(18.0)%		649,844	(7.0)%		698,693
Net premiums earned		555,101	(14.6)%		649,851	(7.3)%		701,047
Claims and policy benefits		677,562	(11.9)%		769,004	(13.5)%		888,658
Acquisition costs		77,689	(19.3)%		96,280	5.9 %		90,923
Operating expenses		16,009	(51.7)%		33,178	(4.8)%		34,838
Net investment income		332,425	(13.2)%		382,995	(1.9)%		390,227
Net fee income and other		290	(17.1)%		350	(49.9)%		698
Realized and unrealized (losses) on investments		(232,375)	NM *		(40,128)	(18.8)%		(33,770)
Contribution from Life Operations	$	(115,819)	NM *	$	94,606	NM *	$	43,783

* NM Not meaningful

The following table is an analysis of the Life Operations gross premiums written, net premiums written and net premiums earned for the last three years ended December 31:

	2009						2008					
(U.S. dollars in thousands)		**Gross Premiums Written**		**Net Premiums Written**		**Net Premiums Earned**		**Gross Premiums Written**		**Net Premiums Written**		**Net Premiums Earned**
Other Life	$	413,831	$	400,345	$	422,594	$	498,387	$	492,346	$	492,353
Annuity		162,331		132,507		132,507		192,528		157,498		157,498

Total	$	576,162	$	532,852	$	555,101	$	690,915	$	649,844	$	649,851

Gross premiums written relating to total life business decreased by $114.8 million in the year to December 31, 2009 as compared to the same period in 2008 mainly due to $79.7 million of lower renewal premiums associated with the short-term life, accident and health business as the renewal rights for this business were sold in late 2008. In addition, while premium growth of $25.6 million was experienced in the core underlying book of term assurance and critical illness business, unfavorable foreign exchange rate movements of $33.7 million more than offset such growth during the year. Partially offsetting these decreases was premium growth of $3.2 million related to U.S. life business. Gross premiums written relating to annuity business decreased by $30.2 million during the year, mainly due to unfavorable exchange rate movements of $26.5 million. While gross premiums written decreased during the year to December 31, 2009, ceded premiums written increased slightly by $2.2 million mainly as a result of the 100% retrocession ratio of the small amount of short-term life, accident and health business underwritten in the 2009 underwriting year, which occurred as part of the sale of the renewal rights as noted above.

While in 2009 and 2008 the Company s Life Operations did not assume any new long duration single premium annuity portfolios, gross and net premiums written, net premiums earned and claims and policy benefits in the year ended December 31, 2007 included the assumption of one Irish immediate annuity portfolio bound, for which net premium earned totaled $94.6 million.

The Company acquired cash and investment assets related to the future policy benefit reserves assumed at inception of this large contract.

Gross premiums written relating to other life business increased by $63.0 million in the twelve months ended December 31, 2008 as compared to the same period in 2007 mainly due to premium growth in the core underlying book of term assurance and critical illness business of $47.0 million and premium growth in U.S. business of $25.0 million, partially offset by unfavorable foreign exchange rate movements of $16.0 million. In addition, gross premiums written related to short-term life, accident and health business increased by $7.0 million primarily as a result of favorable foreign exchange rate movements and partially by decreases in gross premiums written associated with soft market conditions experienced in 2008. Gross premiums written relating to annuity business decreased by $115.3 million during the year ended December 31, 2008 as compared to the same period in 2007 mainly due to a single Irish immediate annuity contract totaling $94.6 million written during 2007, unfavorable foreign exchange rate movements of $19.3 million

and $1.4 million lower premiums from other annuity business which decreases through time as defined by the treaties. Ceded premiums written were roughly consistent with the prior year.

Net premiums earned in the year ended December 31, 2009 decreased 14.6% as compared to the same period in 2008 and in the year ended December 31, 2008 decreased by 7.3% as compared to the same period in 2007. The decrease in 2009 and 2008 were consistent with the movements in total gross and net premiums written as described above.

Changes in claims and policy benefit reserves were generally consistent with movements in gross and net premiums written. Claims and policy benefit reserves decreased by $91.4 million or 11.9% in the year ended December 31, 2009 as compared to the same period in 2008, primarily as a result of the factors noted above affecting gross and net premiums written. Claims and policy benefit reserves decreased by $119.7 million or 13.5% in the year ended December 31, 2008 as compared to the same period in 2007, primarily as a result of the factors noted above affecting gross and net premiums written, combined with a loss recognition adjustment of $25.4 million recorded in 2007 relating to certain novated blocks of U.S.-based term life mortality reinsurance business and partially offset by higher incurred losses of $11.5 million associated with certain short-term life, accident and health business.

For the twelve months ended December 31, 2009, acquisition costs decreased by 19.3% as compared to the same period in 2008, largely as a result of the lower renewal premiums associated with the short-term life, accident and health business as noted above and favorable foreign exchange rate impacts. Operating expenses decreased by 51.7% in the twelve months ended December 31, 2009 as compared to the same period in the prior year mainly due to lower compensation expenses resulting from lower headcount and lower costs related to acquisition of new business.

Acquisition costs in 2008 increased by 5.9% as compared to the same period in 2007, largely as a result of the growth in regular premium business as noted above and partially offset by a favorable profit commission adjustment associated with the short-term life, accident and health business and favorable foreign exchange rate impacts. Operating expenses decreased by 4.8% in the twelve months ended December 31, 2008 as compared to the same period in the prior year mainly due to lower performance-based compensation expenses and a decrease in professional fees as a result of costs recorded in 2007 related to an actuarial loss reserve review.

Net investment income is included in the calculation of contribution from Life Operations, as it relates to income earned on portfolios of separately identified and managed life investment assets and other allocated assets. Net investment income decreased by $50.6 million or 13.2% in the year ended December 31, 2009, as compared to the same period in 2008, primarily as a result of negative foreign exchange rate and yield impacts and partially offset by higher net investment income associated with growth in the average size of the investment asset balances and higher capital allocated to the Life operations. However, it should be noted that, as at December 31, 2009, approximately $0.4 billion of the gross unrealized losses on the Company s investments related to portfolios of Life Operations investment assets primarily as a result of increases in credit spreads during this period, primarily in the U.K. and Euro-zone, and the long duration of the underlying assets. Refer to Balance Sheet Analysis below for further discussion of unrealized losses and gains on investments.

Net investment income decreased by $7.2 million or 1.9% in 2008 as compared to 2007, primarily as a result of negative foreign exchange rate impacts and partially offset by increases in the average size of investment asset balances as a result of putting in more capital.

Syncora

For further information on Syncora, see Results of Operations and Other Revenues and Expenses within Management s Discussion and Analysis of Financial Condition and Results of Operations. In addition, see Item 8, Notes 4 and 10 to the Consolidated Financial Statements, Syncora Holdings Ltd. and Investments in Affiliates , for further information.

Investment Activities

The following table illustrates the change in net investment income from property and casualty operations, net income (loss) from investment fund affiliates, net realized (losses) on investments, and net

realized and unrealized (losses) on investment and other derivative instruments for each of the three years ended December 31:

(U.S. dollars in thousands)	**2009**	**% Change 2009 vs 2008**	**2008**	**% Change 2008 vs 2007**	**2007**
Net investment income property and casualty operations (1)	$ 882,748	(24.9)%	$ 1,174,856	(8.9)%	$ 1,289,554
Net income (loss) from investment fund affiliates (2)	78,867	NM *	(277,696)	NM *	326,007
Net realized (losses) on investments (3)	(921,437)	4.2 %	(962,054)	(59.5)%	(603,268)
Net realized and unrealized (losses) on investment and other derivative instruments (4)	(33,647)	54.1 %	(73,368)	(32.3)%	(55,451)

(1) Net investment income relating to property and casualty operations does not include the net investment income related to the net results from structured

products.

(2) The Company records the income related to alternative fund affiliates on a one-month lag and the private investment fund affiliates on a three-month lag in order for the Company to meet the accelerated filing deadlines.

(3) Results to March 31, 2009 include charges for OTTI related to the non-credit impairment of unrealized losses. From April 1, 2009, the non-credit impairment is excluded from realized losses.

(4) For a summary of realized and unrealized gains and losses on all derivative instruments, see Item 8,

Note 17 to the Consolidated Financial Statements, Derivative Instruments.

* NM Not meaningful

Net investment income related to property and casualty operations decreased in the year ended December 31, 2009 as compared to the same period in 2008 due primarily to declining portfolio yields. Overall, investment portfolio yields have decreased as a result of the impact of declines in short-term U.S. interest rates, and particularly the impact of decreased U.S. Dollar Libor on the Company s floating rate securities previously supporting the GIC and funding agreement business. In addition, the Company increased its holdings in lower-yielding cash, government and agency securities in connection with its portfolio de-risking efforts as the Company re-aligns its portfolio to one more in line with a P&C portfolio and to increase liquidity.

Net income from investment fund affiliates includes earnings from the Company s investments in closed-end investment funds and partnerships and similar vehicles that are equity accounted.

Net income from investment fund affiliates in the year ended December 31, 2009 resulted from the significant improvement in market sentiment and rallies in risk assets. Credit sensitive and relative value managers particularly benefited from tightening credit spreads and normalization of previously dislocated relative value relationships. Volatility remained high relative to historical levels, allowing alternative managers to be more opportunistic and take advantage of pricing dislocations, but offset by the negative mark-to-market in its private investment portfolio reflecting fair value adjustments, particularly from fourth quarter of 2008.

Net loss from investment fund affiliates in the year ended December 31, 2008 reflected negative returns in the company s alternative portfolio as a result of broad-based market declines, extreme volatility, a sharp pull-back in the availability of credit and short sale restrictions resulting from the market credit crisis. Net income from investment fund affiliates in the year ended December 31, 2007 reflected exceptional results in the alternative portfolio, combined with a higher investment base.

Investment Performance

The Company manages its investment grade fixed income securities in accordance with investment guidelines approved by the Finance Committee of the Board of Directors. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful. Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the

investment portfolio returns for the years ended December 31, 2009 and 2008 of the fixed income portfolio and non-fixed income portfolios:

	2009(1)	**2008(1)**
Fixed income Portfolio		
USD fixed income portfolio	7.9%	(9.2)%
GBP fixed income portfolio	11.2%	(5.0)%
EUR fixed income portfolio	7.9%	(1.0)%
Other Portfolios		
Alternative portfolio (2).	16.0%	(16.3)%
Equity portfolio	(8.2)%	(44.1)%
High-Yield fixed income portfolio	47.1%	(22.9)%

(1) Portfolio returns are calculated by dividing the sum of the net investment income or net income from investment fund affiliates, realized gains (losses) and unrealized gains (losses) by the average market value of each portfolio. Performance is measured in either the underlying asset currency or the functional

currency.

(2) Performance on the alternative portfolio reflects the twelve months ended November 30, 2009 and 2008, respectively.

Net Realized Gains and Losses on Investments

Net realized losses on investments in the twelve months ended December 31, 2009 included net realized losses of approximately $812.5 million related to the write-down of certain of the Company s fixed income, equity and other investments, as compared to $1.0 billion for the year ended December 31, 2008. Impairment charges to March 31, 2009 include charges of OTTI related to the non-credit impairment of unrealized losses. From April 1, 2009, as a result of changes in GAAP, the non-credit impairment is excluded from net impairments. In addition, included in the net realized losses noted above are net realized losses of $131.9 million from sales of investments and net realized losses of $10.9 million from the sale of the U.S. life reinsurance business.

The significant assumptions and inputs associated with the net impairment charges of $812.5 million consist of:

For corporate securities, excluding medium term notes backed primarily by investment grade European credit, the Company recorded net impairments totaling $151.8 million for the year ended December 31, 2009. The impairment charges consisted of below-investment grade securities and hybrids, where the Company considered

impairment factors consistent with both equity impairment model and debt impairment model, and, accordingly, recorded impairment charges to fair value, or securities in an unrealized loss position that management intended to sell.

In addition, the Company recorded impairments totaling $226.9 million for the year ended December 31, 2009 in relation to medium term notes backed primarily by investment grade European credit. Management has concluded that, following credit spread movements during 2009, future yields within the supporting collateral were not sufficient to support the previously reported amortized cost.

For structured credit securities, the Company recorded net

impairments of $406.6 million for the year ended December 31, 2009. The Company determined that the likely recovery on these securities was below the carrying value, and, accordingly, impaired the securities to the discounted value of the cash flows of these securities.

For equity securities, the Company recorded net impairments of $27.2 million for the year ended December 31, 2009, respectively, primarily representing securities in an unrealized loss position that management does not have the intent to hold to recovery.

For the year ended December 31, 2009, included in the above totals is $160.6 million related to changes to intent-to-hold up to March 31, 2009, or intent to sell from April, 2009, primarily representing exchanges of

hybrid securities,
and as part of the
fourth quarter
2008 restructuring
charge.

Net realized losses on investments in the twelve months ended December 31, 2008 included net realized losses of approximately $1,023.6 million related to the write-down of certain of the Company s fixed income, equity and other investments, including those relating to Lehman, where the Company

determined that there was an other than temporary decline in the value of those investments, including a charge of $400.0 million related to assets for which the Company could no longer assert its intent to hold until recovery. See below for further information.

During the fourth quarter of 2008, management recorded a charge for OTTI of $400.0 million on assets for which it could no longer assert its intent to hold until recovery. Although management believed that these securities were likely to recover to their current amortized cost, it determined that these securities were at- risk for further mark-to-market declines, and potentially real economic losses, to the extent that economic conditions were to deteriorate further than present estimates and the Company s allocation to these asset classes is overweight relative to a traditional P&C investment portfolio.

In 2007, net realized losses on investments were $603.3 million which included $1,012.8 million of gross realized losses on fixed income and $46.9 million of gross realized losses on equity securities. Gross realized losses in 2007 included $611.0 million of provisions for declines in fair value considered to be other than temporary. As a percentage of the total fixed income portfolio, the write-down for other than temporary declines was 1.5% in 2007.

Net Realized and Unrealized Gains and Losses on Derivatives

Net realized and unrealized losses on investment derivatives for the years ended December 31, 2009, 2008 and 2007 resulted from the Company s investment strategy to manage interest rate risk, foreign exchange risk and credit risk, and to replicate permitted investments. Derivative losses in 2009 relate primarily to the impact of tightening credit spreads on certain credit derivatives purchased within the investment portfolio. In 2008, derivative losses were driven by foreign currency exchange losses recognized on a Sterling forward currency contract hedging US dollar assets supporting Sterling liabilities in the life operations during the year. In 2007, the results were driven primarily from a mark-to-market loss of $37.0 million with respect to a total return swap on the capital notes of a structured investment vehicle impacted by the markdown in the underlying net asset value of the assets underlying the capital notes, combined with mark-to-market losses associated with the Company s capital, investment and hedging activities.

For a further discussion see Item 7A, Quantitative and Qualitative Disclosures About Market Risk and Liquidity and Capital Resources.

Other Revenues and Expenses

The following table sets forth other revenues and expenses of the Company for each of the three years ended December 31:

(U.S. dollars in thousands)		**2009**	**% Change 2009 vs 2008**		**2008**	**% Change 2008 vs 2007**		**2007**
Net income (loss) from operating affiliates (1)	$	60,480	NM *	$	(1,458,246)	(37.6)%	$	(1,059,848)
Exchange (gains) losses		84,813	NM *		(184,454)	NM *		(19,734)
Corporate operating expenses		107,877	(35.9)%		168,324	20.7 %		139,469
			NM *		22,527	NM *		

Extinguishment of debt					
Interest expense (2)	172,764	(16.3)%	206,455	(1.9)%	210,449
Impairment of goodwill		NM *	989,971	NM *	
Amortization of intangible assets	1,836	(38.1)%	2,968	76.7 %	1,680
Income tax expense	120,307	(45.9)%	222,578	(4.8)%	233,922
Non-controlling interest in net (gain) loss of subsidiary	(104)	NM *		(100.0)%	23,928

(1) The Company records the income related to certain operating affiliates on a three-month lag in order for the Company to meet accelerated filing deadlines.

(2) Interest expense does not include interest expense related structured products as reported within the Insurance

and Reinsurance segments.

* NM Not meaningful

The following table sets forth the net income (loss) from operating affiliates for each of the three years ended December 31:

(U.S. dollars in thousands)	**2009**	**% Change 2009 vs 2008**	**2008**	**% Change 2008 vs 2007**	**2007**
Net (loss) income from financial operating affiliates	$ 3,629	100.2 %	$ (1,503,474)	(26.3)%	$ (1,190,161)
Net income from investment manager affiliates	17,698	63.0 %	10,860	(88.5)%	94,630
Net income from other strategic operating affiliates	39,153	13.9 %	34,368	(3.7)%	35,683
Total	$ 60,480	104.1 %	$ (1,458,246)	(37.6)%	$ (1,059,848)

Equity earnings from financial operating affiliates increased during the year ended December 31, 2009 as compared to the same period of 2008 as a result of the Company s disposition of its interest in Syncora. During the year ended December 31, 2008, the Company recorded $1.4 billion in losses related to reinsurance and guarantee arrangements with Syncora. Net losses from financial operating affiliates in 2007 include the results and related write-downs associated with Syncora and Primus Guaranty Ltd as well as the impact of losses recorded on previous reinsurance transactions with Syncora. For further details relating to Syncora and the closing of the Master Agreement, see Results of Operations above as well as Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd. (Syncora).

Investment manager affiliate income increased by 63.0% during the year ended December 31, 2009 as compared to the same period in the prior year primarily as a result of the improved conditions for alternative asset managers in the second half of 2009 resulting in higher accrued fees. The Company also benefited from a modest gain associated with its withdrawal at the end of 2009 from one of its investment manager affiliates. Investment manager affiliate income decreased by $83.8 million or 88.5% during the year ended December 31, 2008 as compared to the prior year primarily as a result of the volatility in both the credit and equity markets, impacting investment manager affiliates specializing in global equities and fixed income securities most significantly.

As a result of improving market conditions, there were small increases across the strategic operating affiliates portfolio, which increased income by 13.9% in the year ended December 31, 2009 over the same period of 2008. Net income from other strategic operating affiliates decreased in the year ended December 31, 2008 as compared to 2007 mainly due to lower earnings reported in 2008 from both an insurance affiliate which writes largely direct U.S. homeowners insurance and the Company s Brazilian joint venture ITAÚ XL. Offsetting these decreases was earnings from an investment in an affiliate entered into in the second quarter of 2008 that provides reinsurance to certain Lloyd s syndicates. Net income from other strategic operating affiliates in 2007 was primarily as a result of strong results from the same insurance affiliate noted above which writes largely U.S. homeowners insurance and the Company s Brazilian joint venture ITAÚ XL.

Foreign exchange losses in the year ended December 31, 2009 were primarily to the change in the value of the U.S. dollar against certain currencies including the U.K. Sterling and Euro on certain inter-company balances.

Corporate operating expenses decreased by 35.9% during the year ended December 31, 2009 as compared to 2008 primarily as a result of the cost savings achieved from the restructuring activities implemented in 2008 and early 2009 as well as higher professional fees associated with the capital raise and associated costs related to the Master Agreement that was executed in July 2008. For further information, see Note 5 to the Consolidated Financial Statements, Restructuring and Asset Impairment Charges.

In connection with the early redemption of the 6.58% Notes noted above, the Company recorded debt extinguishment costs of approximately $22.5 million in 2008.

Interest expense from property and casualty operations includes costs related to the Company s debt and collateral facilities as well as certain deposit liability accretion. Interest expense for the year ended December 31, 2009 as compared to the same period in 2008 was lower mainly as a result of lower interest associated with the retirement of the 2011 Senior Notes in February 2009 partially offset by interest

associated with 8.25% senior notes which are part of the 10.75% Equity Security Units issued in August 2008. Interest expense for the year ended December 31, 2008 as compared to the same period in 2007 was lower primarily due to costs associated with the retirement of the 2009 Senior Notes recorded in 2007, lower interest expense as a result of the early redemption, in August 2008, of X.L. America, Inc. s 6.58% Notes and was partially offset by interest expense associated with the 10.75% Equity Security Units (the 10.75% Units) issued in August 2008. For more information on the Company s financial structure, see Liquidity and Capital Resources.

Due to the financial market and economic events that occurred in the fourth quarter of fiscal 2008, the Company performed an interim impairment test for goodwill subsequent to its annual testing date of June 30. The interim impairment test resulted in a non-cash goodwill impairment charge of approximately $990.0 million. For further information, see Item 8, Note 7 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets and see further discussion under Critical Accounting Policies and Estimates.

Amortization of intangible assets increased in 2008 as a result of the increase in intangible assets related to the XL GAPS acquisition in 2007. Amortization of intangible assets decreased in 2007 as a result of certain intangible assets that were fully amortized during 2006.

The decrease in the Company s income taxes in 2009 as compared to 2008 arose principally from the decrease in the profitability of the Company s U.S. and European operations. The decrease in the Company s income taxes in 2008 as compared to 2007 was primarily a result of a change in the geographical locations of the profits earned primarily by the Company s U.S. and European operations, including the impact of losses associated with the Master Agreement and goodwill impairment charges related to operating entities in jurisdictions not subject to income tax. The Company s effective tax rate for 2008 differed as compared to 2007 mainly due to significant charges for which no tax benefit accrued and which resulted in a loss before tax. See Critical Accounting Policies and Estimates and Item 8, Note 24 to the Consolidated Financial Statements, Taxation.

Non-controlling interest expense in 2007 related primarily to the 37% ownership interest in Syncora common shares held by the public prior to the secondary offering of Syncora common shares on June 6, 2007.

Balance Sheet Analysis

Investments

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

At December 31, 2009 and 2008, total investments, cash and cash equivalents, accrued investment income and net receivable for investments sold were $35.9 billion and $34.3 billion, respectively. The following table summarizes the composition of the Company s invested assets at December 31, 2009 and 2008:

(U.S. dollars in thousands)	**Carrying value 2009 (1)**	**Percent of Total**	**Carrying Value 2008 (1)**	**Percent of Total**
Cash and cash equivalents.	$ 3,643,697	10.2 %	$ 4,353,826	12.7 %
Net receivable for investments sold	47,638	0.1 %	99,455	0.3 %
Accrued investment income	350,055	1.0 %	363,376	1.1 %
Short-term investments	1,777,360	5.0 %	1,466,323	4.3 %
Fixed maturities, available for sale:				
U.S. Government and Government-Related/Supported	2,664,625	7.4 %	3,978,342	11.6 %
Corporate	9,799,000	27.3 %	9,288,603	27.1 %
Residential mortgage-backed securities Agency	6,228,501	17.4 %	2,099,955	6.1 %
Residential mortgage-backed securities Non-Agency	1,421,315	4.0 %	1,937,946	5.6 %
Commercial mortgage-backed securities	1,216,799	3.4 %	2,141,568	6.2 %
Collateralized debt obligations	698,561	1.9 %	638,779	2.0 %
Other asset-backed securities	1,167,985	3.3 %	1,708,008	5.0 %
U.S. States and political subdivisions of the States	913,473	2.5 %	468,770	1.4 %
Non-U.S. Sovereign Government, Supranational and Government-Related	3,401,773	9.5 %	3,374,397	9.8 %
Total fixed maturities.	$ 27,512,032	76.7 %	$ 25,636,368	74.8 %
Fixed maturities, held to maturity	546,067	1.5 %		%
Equity securities	17,779	0.0 %	361,819	1.0 %
Investments in affiliates	1,185,604	3.3 %	1,552,789	4.5 %
Other investments	783,189	2.2 %	459,481	1.3 %
Total investments and cash and cash equivalents	**$ 35,863,421**	**100.0 %**	**$ 34,293,437**	**100.0 %**

(1) Carrying value represents the fair value for available for sale

fixed
maturities
and
amortized
cost for
held to
maturity
securities.

The Company reviews on a regular basis its issuer concentration, credit quality and compliance with established guidelines. At December 31, 2009 and 2008, the average credit quality of the Company s total fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) was AA. At December 31, 2009, approximately 55.2% of the fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net receivable for investments sold) was rated AAA by one or more of the principal ratings agencies. Approximately 3.5% of the fixed income portfolio was below investment grade or not rated.

At December 31, 2009 and 2008, total investments, cash and cash equivalents, accrued investment income and net receivable for investments sold were $35.9 billion and $34.3 billion, respectively. This increase of $1.5 billion was primarily due to the mark-to-market effect as a result of the improving credit markets.

Refer to Results of Operations for further discussion surrounding the impact of credit market movements on the Company s investment portfolio and exposure to sub-prime related assets.

Gross and Net Unrealized Gains and Losses on Investments

At December 31, 2009, the Company had net unrealized losses on available for sale fixed maturities and short-term investments of $1,276.3 million and net unrealized gains on equity securities of $5.4 million. Of these amounts, gross unrealized losses on fixed maturities and short-term investments and equities were $1,847.9 million and $0.4 million, respectively. At December 31, 2008, the Company had net unrealized losses on fixed maturities and short-term investments of $3,388.6 million and net unrealized gains on equity securities of $24.1 million. Of these amounts, gross unrealized losses on fixed maturities and short-term investments and equities were $4,122.3 million and $7.6 million, respectively. The impact of tightening credit spreads during the twelve months ended December 31, 2009 was the primary reason for the improvement in the net unrealized position on fixed maturities and short-term investments combined with net realized losses over the course of the year, offset by the impact of increasing government rates. The information shown below about the unrealized losses on the Company s investments at December 31, 2009

and 2008 may affect future earnings and financial position should management later conclude that some of the current declines in the fair value of these investments are other than temporary.

The following is an analysis of how long each of those investment securities with an unrealized loss at December 31, 2009 and 2008 had been in a continual unrealized loss position:

Type of Securities *(U.S. dollars in thousands)*	**Length of time in a continual unrealized loss position**	**Amount of unrealized loss at December 31, 2009**	**Amount of unrealized loss at December 31, 2008**
Fixed-Maturities and Short-Term Investments	Less than six months	$ 160,313	$ 798,866
	At least 6 months but less than 12 months	93,474	664,593
	At least 12 months but less than 2 years	466,656	1,955,760
	2 years or more	1,127,407	703,104
	Total	$ 1,847,850	$ 4,122,323
Equities	Less than six months	$ 17	$ 5,584
	At least 6 months but less than 12 months	341	1,994
	Total	$ 358	$ 7,578

At December 31, 2009 and 2008, the following table sets forth the maturity profile of the fixed income securities that were in a gross unrealized loss position:

Maturity profile in years of fixed income securities in a gross unrealized loss position *(U.S. dollars in thousands)*	**Amount of unrealized loss at December 31, 2009**	**Amount of unrealized loss at December 31, 2008**
Less than 1 year remaining	$ 6,736	$ 38,702
At least 1 year but less than 5 years remaining (1)	175,142	622,011
At least 5 years but less than 10 years remaining (1)	93,427	438,837
More than 10 years but less than 20 years remaining (1)	92,321	205,371
At least 20 years or more remaining (1)	331,807	843,274
Residential mortgage-backed securities - Agency	37,921	2,466
Residential mortgage-backed securities - Non-Agency	608,236	951,507
Commercial mortgage-backed securities	67,910	365,330
Collateralized debt obligations	341,467	465,100
Other asset-backed securities	92,883	189,725

Total	$ 1,847,850	$ 4,122,323

(1) Hybrids are allocated on the call date and medium term notes are allocated on contractual maturity.

The following table details the Company s corporate credit exposures by certain asset classes as well as ratings levels within the Company s aggregate fixed income portfolio and the current net unrealized (loss) position as at December 31, 2009 and 2008:

(U.S. dollars in millions) **As at December 31, 2009:**	**AAA**	**AA**	**A**	**BBB**	**BB & Below**	
Financials						
Fair value	$ 382.4	$ 925.3	$ 2,093.2	$ 515.4	$ 33.1	$
Net unrealized gain (loss)	$ (2.0)	$ 7.6	$ (186.7)	$ (112.3)	$ (4.8)	$
Non-Financials						
Fair value	$ 96.1	$ 1,412.6	$ 3,363.4	$ 1,254.4	$ 397.2	$
Net unrealized gain (loss)	$ 2.3	$ 6.0	$ 28.0	$ (53.4)	$ 1.3	$
Total						
Fair value	$ 478.5	$ 2,337.9	$ 5,456.6	$ 1,769.8	$ 430.3	$
Net unrealized gain (loss)	$ 0.3	$ 13.6	$ (158.7)	$ (165.7)	$ (3.5)	$
As at December 31, 2008:						
Financials						
Fair value	$ 712.4	$ 1,280.6	$ 2,153.3	$ 343.4	$ 64.7	$
Net unrealized (loss)	$ (14.6)	$ (145.4)	$ (659.5)	$ (158.2)	$ (44.0)	$
Non-Financials						
Fair value	$ 521.8	$ 711.4	$ 2,213.2	$ 1,511.6	$ 552.9	$
Net unrealized (loss)	$ (14.7)	$ (22.6)	$ (307.2)	$ (306.9)	$ (216.6)	$
Total						
Fair value	$ 1,234.2	$ 1,992.0	$ 4,366.5	$ 1,855.0	$ 617.6	$
Net unrealized (loss)	$ (29.3)	$ (168.0)	$ (966.7)	$ (465.1)	$ (260.6)	$

At December 31, 2009, approximately $1.7 billion of the Company s $3.9 billion in corporate financial sector securities was held in the portfolios supporting the Company s life reinsurance business. Management completed a strategic review of the Company s life reinsurance business, which are now in run-off. The assets associated with that business are more heavily weighted towards longer term securities from financial institutions, including Tier 1 and Upper Tier 2 securities, with a fair value of $0.7 billion representing committed term debt and hybrid instruments senior to the common and preferred equity of the financial institutions, and accounted for $175.9 million of the Company s net unrealized loss as at December 31, 2009. As at December 31, 2009, subordinated debt securities (including Lower Tier Two) had a fair value of $0.5 million and a net unrealized loss of $54.3 million. As at December 31, 2009 approximately 42.7% of the overall sensitivity to interest rate risk and 36.2% to credit risk was

related to the Life investment portfolio, despite these portfolios accounting for only 19.0% of the Company s aggregate fixed income portfolio.

The following table details the Company s structured credit exposures by certain asset classes as well as ratings levels within the Company s aggregate fixed income portfolio and the current net unrealized gain (loss) position as at December 31, 2009 and 2008:

(U.S. dollars in millions) **As at December 31, 2009:**				**Current Rating**								
		AAA		**AA**		**A**		**BBB**		**BB & Below**		**Total**
CMBS												
Fair value	$	1,033.0	$	144.2	$	21.0	$	9.3	$	15.5	$	1,223.0
Net unrealized (loss)	$	(23.3)	$	(15.0)	$	(7.0)	$	(0.9)	$	(11.8)	$	(58.0
Prime RMBS												
Fair value	$	146.1	$	86.7	$	30.4	$	46.4	$	174.4	$	484.0
Net unrealized (loss)	$	(9.4)	$	(28.8)	$	(7.7)	$	(7.7)	$	(34.6)	$	(88.2
Topical Assets (1)												
Fair value	$	101.7	$	95.7	$	98.2	$	74.3	$	367.7	$	737.6
Net unrealized (loss)	$	(24.6)	$	(38.4)	$	(73.1)	$	(52.6)	$	(293.7)	$	(482.4
Core CDOs (2)												
Fair value	$	70.5	$	146.2	$	252.1	$	77.2	$	154.9	$	700.9
Net unrealized (loss)	$	(15.0)	$	(34.2)	$	(100.1)	$	(39.7)	$	(144.3)	$	(333.3
Other Asset & Mortgage Backed Securities												
Fair value	$	811.4	$	182.3	$	256.2	$	127.1	$	33.2	$	1,410.2
Net unrealized (loss)	$	(15.9)	$	(16.0)	$	(15.4)	$	(26.9)	$	(25.9)	$	(100.1
Agency RMBS												
Fair value	$	6,256.6	$		$		$		$		$	6,256.6

Net unrealized gain	$ 64.4	$	$	$	$	$ 64.4
Total						
Fair value	$ 8,419.3	$ 655.1	$ 657.9	$ 334.3	$ 745.7	$ 10,812.3
Net unrealized (loss)	$ (23.8)	$ (132.4)	$ (203.3)	$ (127.8)	$ (510.3)	$ (997.6
As at December 31, 2008:						
CMBS						
Fair value	$ 2,101.5	$ 15.2	$ 15.4	$ 11.8	$ 10.6	$ 2,154.5
Net unrealized (loss)	$ (331.8)	$ (5.1)	$ (4.9)	$ (7.7)	$ (12.4)	$ (361.9
Prime RMBS						
Fair value	$ 752.6	$ 132.1	$ 57.1	$ 14.6	$ 36.3	$ 992.7
Net unrealized (loss)	$ (218.8)	$ (67.0)	$ (45.5)	$ (5.0)	$ (13.0)	$ (349.3
Topical Assets (1)						
Fair value	$ 558.3	$ 183.7	$ 98.9	$ 48.0	$ 74.6	$ 963.5
Net unrealized (loss)	$ (312.5)	$ (157.5)	$ (63.4)	$ (24.7)	$ (36.5)	$ (594.6
Core CDOs (2)						
Fair value	$ 166.1	$ 324.4	$ 51.7	$ 110.3	$ 13.7	$ 666.2
Net unrealized (loss)	$ (61.7)	$ (173.9)	$ (46.6)	$ (163.7)	$ (24.1)	$ (470.0
Other Asset & Mortgage Backed Securities						
Fair value	$ 1,253.3	$ 108.1	$ 267.6	$ 61.7	$ 28.2	$ 1,718.9
Net unrealized (loss)	$ (57.3)	$ (18.3)	$ (74.1)	$ (28.9)	$ (2.3)	$ (180.9
Agency RMBS						
Fair value	$ 2,109.8	$	$	$	$	$ 2,109.8

Net unrealized (loss)	$	63.1	$		$		$		$		$	63.1
Total												
Fair value	$	6,941.6	$	763.5	$	490.7	$	246.4	$	163.4	$	8,605.8
Net unrealized (loss)	$	(919.0)	$	(421.8)	$	(234.5)	$	(230.0)	$	(88.3)	$	(1,893.6

(1) Topical assets represent non-agency RMBS securities with sub-prime, Alt-A, second lien or ABS CDO collateral.

(2) The Company defines Core CDOs as investments in non-sub-prime collateralized debt obligations, primarily consisting of collateralized loan obligations.

The following table details the current exposures to Topical Assets and Core CDOs within the Company s fixed income portfolio as well as the current net unrealized gain (loss) positions as at December 31, 2009 and December 31, 2008:

(U.S. dollars in thousands)	As at December 31, 2009			As at December 31, 2008		
	Holding at Fair Value	**Percent of Fixed Income Portfolio**	**Net Unrealized Gain (Loss)**	**Holding at Fair Value**	**Percent of Fixed Income Portfolio**	**Net Unrealized Gain (Loss)**
Topical Assets:						
Sub-prime first lien mortgages	$ 377,609	1.1 %	$ (252,745)	$ 487,659	1.5 %	$ (311,435)
Alt-A mortgages	316,795	0.9 %	(209,731)	406,098	1.3 %	(270,486)
Second lien mortgages (including sub-prime second lien mortgages)	37,776	0.1 %	(19,920)	58,903	0.2 %	(5,313)
ABS CDOs with sub-prime collateral	5,429	%	32	10,595	0.0 %	(7,308)
Total exposure to Topical Assets	$ 737,609	2.1 %	$ (482,364)	$ 963,255	3.0 %	$ (594,542)
Core CDOs	$ 700,884	2.1 %	$ (333,257)	$ 666,239	2.1 %	$ (469,976)

Of the total Topical Assets with fair value exposure as at December 31, 2009 and December 31, 2008 of $0.7 billion and $1.0 billion, respectively, approximately $32.8 million and $40.5 million, respectively, of the related securities had ratings dependent on guarantees issued by third party guarantors (i.e., monoline insurers). Decreases in the ratings of such third party guarantors would typically decrease the fair value of guaranteed securities; however, at December 31, 2009, in the event of non-performance at such date on the part of these third party guarantors, the Company estimated that the average credit quality of this portfolio would be A and that approximately 90.9% would have remained investment grade at such date. In addition, of the Company s aggregate fixed income portfolio as at December 31, 2009 and December 31, 2008, of $33.9 billion and $31.9 billion, respectively, less than 2% were

guaranteed by such third parties with no individual third party representing more than 1%. In assessing these securities for other-than-temporary impairment, the Company reviews forecasted cash flows from the underlying collateral only, and does not assume that any payment will be made by these third party guarantors.

At December 31, 2009, the Company s sub-prime and Alt-A exposures had adequate underlying loan characteristics and the Company believed at such date that they were supported by adequate subordination levels based on current expectations of house price declines, loss severities and default levels. The Company had approximately $696.8 million of Topical Assets downgraded during the year ended December 31, 2009. However, 50.1% of the Company s holdings remain rated investment grade at December 31, 2009.

During the year ended December 31, 2008, liquidations necessary to fund the repayment of the GIC liabilities following the downgrade of Syncora Guarantee and the maturity of certain funding agreements were funded through sales of assets in the Other Financial Lines segment investment portfolios as well as the general investment portfolio. Management s approach was to avoid the sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold Topical Assets and core CDOs, with a fair value of $1.4 billion which it has primarily transferred to the general portfolio.

For a discussion on the significant drivers of the gross unrealized losses at December 31, 2009, please refer to Item 8, Note 9 to the Consolidated Financial Statements Investments for further information.

The following table summarizes the fair value, gross unrealized losses, credit rating and asset class of securities in a gross unrealized loss position within the Company s structured credit and corporate portfolios, which comprised $1.7 billion of the Company s total gross unrealized loss position of $1.8 billion at December 31, 2009:

(U.S. dollars in millions)										
Corporates		**AAA**		**AA**		**A**		**BBB**		**BB & Below**
Financials (1)										
Fair value	$	160.7	$	280.5	$	1,389.4	$	474.7	$	21.2
Gross unrealized loss (3)	$	(8.4)	$	(19.8)	$	(215.5)	$	(114.7)	$	(9.2)
Non-Financials (2)										
Fair value	$	24.3	$	536.8	$	1,267.7	$	532.7	$	174.8
Gross unrealized loss (3)	$	(0.4)	$	(30.5)	$	(70.0)	$	(94.5)	$	(20.5)
Total										
Fair value	$	185.0	$	817.3	$	2,657.1	$	1,007.4	$	196.0
Gross unrealized loss (3)	$	(8.8)	$	(50.3)	$	(285.5)	$	(209.2)	$	(29.7)
% Impaired (of amortized cost) (3)		(4.6)%		(5.9)%		(9.9)%		(17.5)%		(13.4)%

Structured Credit		**AAA**		**AA**		**A**		**BBB**		**BB & Below**	
CMBS											
Fair value	$	623.2	$	142.2	$	14.7	$	4.3	$	9.1	$
Gross unrealized loss (3)	$	(29.6)	$	(15.4)	$	(8.0)	$	(1.3)	$	(13.6)	$
Prime RMBS											
Fair value	$	133.7	$	83.9	$	25.6	$	46.4	$	166.6	$
Gross unrealized loss (3)	$	(10.6)	$	(29.4)	$	(7.8)	$	(7.7)	$	(37.2)	$
Topical Assets											
Fair value	$	101.7	$	88.2	$	97.7	$	67.6	$	356.6	$
	$	(24.6)	$	(38.5)	$	(73.1)	$	(52.9)	$	(295.9)	$

Gross unrealized loss (3)											
Core CDO s (4)											
Fair value	$	70.3	$	146.2	$	251.6	$	77.0	$	145.7	$
Gross unrealized loss (3)	$	(15.0)	$	(34.2)	$	(100.1)	$	(39.8)	$	(153.1)	$
Other Asset & Mortgage Backed Securities											
Fair value	$	514.9	$	137.9	$	199.2	$	110.5	$	33.2	$
Gross unrealized loss (3)	$	(26.4)	$	(17.0)	$	(16.7)	$	(27.5)	$	(36.2)	$
Agency RMBS											
Fair value	$	2,963.4	$		$		$		$		$
Gross unrealized loss (3)	$	(37.9)									
Total											
Fair Value	$	4,407.2	$	598.4	$	588.8	$	305.8	$	711.2	$
Gross unrealized loss (3)	$	(144.1)	$	(134.5)	$	(205.7)	$	(129.2)	$	(536.0)	$
% Impaired (of amortized cost) (3)		(3.2)%		(18.4)%		(26.0)%		(29.8)%		(42.4)%	

(1) Included in the gross unrealized losses on corporate financials are gross unrealized losses of $225.2 million

on Tier One and Upper Tier Two securities of financial institutions (Hybrids), as well as $84.3 million on subordinated debt.

(2) Included within Corporate are certain floating rate medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes have a fair value of $587.7 million and an amortized cost of $707.9 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.

(3) Management considers these impairments to be temporary.

(4) The Company defines Core CDOs as investments in non-mortgage collateralized debt obligations, primarily consisting of collateralized loan obligations.

The following table summarizes the fair value, gross unrealized losses, credit rating and asset class of securities in a gross unrealized loss position within the Company s structured credit and corporate portfolios, which comprised $3.9 billion of the Company s total gross unrealized loss position of $4.1 billion at December 31, 2008:

(U.S. dollars in millions)										
Corporates		**AAA**		**AA**		**A**		**BBB**		**BB & Below**
Financials (1)										
Fair value	$	435.2	$	1,014.2	$	2,079.8	$	222.1	$	36.5
Gross unrealized loss (3)	$	(25.4)	$	(149.0)	$	(660.5)	$	(159.8)	$	(44.0)
Non-Financials (2)										
Fair value	$	184.9	$	302.4	$	1,407.9	$	1,211.2	$	463.0
Gross unrealized loss (3)	$	(25.5)	$	(35.8)	$	(335.3)	$	(311.4)	$	(230.1)
Total										
Fair value	$	620.1	$	1,316.6	$	3,487.7	$	1,433.3	$	499.5
Gross unrealized loss (3)	$	(50.9)	$	(184.8)	$	(995.8)	$	(471.2)	$	(274.1)
% Impaired (of amortized cost) (3)		(7.8)%		(12.5)%		(22.6)%		(25.1)%		(35.9)%

Structured Credit		**AAA**		**AA**		**A**		**BBB**		**BB & Below**	
CMBS											
Fair value	$	1,426.6	$	7.9	$	6.7	$	9.5	$	8.8	$
Gross unrealized loss (3)	$	(331.9)	$	(5.1)	$	(4.9)	$	(7.7)	$	(12.4)	$
Prime RMBS											
Fair value	$	618.4	$	125.5	$	56.6	$	8.0	$	24.8	$
Gross unrealized loss (3)	$	(220.3)	$	(67.7)	$	(45.7)	$	(5.9)	$	(13.9)	$
Topical Assets											
Fair value	$	534.0	$	175.8	$	87.0	$	28.4	$	53.5	$
	$	(312.6)	$	(157.5)	$	(63.7)	$	(29.9)	$	(39.3)	$

Gross unrealized loss (3)											
Core CDO s (4)											
Fair value	$	166.7	$	324.6	$	51.7	$	109.2	$	10.2	$
Gross unrealized loss (3)	$	(61.7)	$	(173.9)	$	(46.6)	$	(163.7)	$	(24.4)	$
Other Asset & Mortgage Backed Securities											
Fair value	$	790.0	$	97.9	$	220.8	$	60.4	$	27.8	$
Gross unrealized loss (3)	$	(58.2)	$	(18.4)	$	(74.1)	$	(28.9)	$	(2.3)	$
Agency RMBS											
Fair value	$	27.5	$		$		$		$		$
Gross unrealized loss (3)	$	(2.4)									
Total											
Fair Value	$	3,563.2	$	731.7	$	422.8	$	215.5	$	125.1	$
Gross unrealized loss (3)	$	(987.1)	$	(422.6)	$	(235.0)	$	(236.1)	$	(92.3)	$
% Impaired (of amortized cost) (3)		(21.8)%		(36.8)%		(35.9)%		(52.7)%		(42.8)%	

(1) Included in the gross unrealized losses on corporate financials are gross unrealized losses of $637.1 million

on Tier One and Upper Tier Two securities of financials institutions (Hybrids), as well as $159.2 million on subordinated debt.

(2) Included within Corporate are certain floating rate medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes have a fair value of $499.0 million and an amortized cost of $922.7 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.

(3) Management considers these impairments to be temporary.

(4) The Company defines Core CDOs as investments in non-sub-prime collateralized debt obligations, primarily consisting of collateralized loan obligations.

Structured credit securities with gross unrealized losses representing greater than 50% of amortized cost account for $379.4 million of gross unrealized losses, with a fair value of $202.3 million. Of these gross unrealized losses, $112.0 million are rated investment grade. The Company has evaluated each of these holdings on a security-by-security basis in conjunction with its investment manager service providers and utilizing additional corroborative modeling techniques, and believes these securities will provide adequate principal and interest payments to satisfy the current amortized cost. These securities include $213.1 million

of Topical assets, $131.1 million of Core CDOs, $1.2 million of prime RMBS and $12.8 million of CMBS holdings.

As noted in Item 8, Note 2 to the Consolidated Financial Statements, Significant Accounting Policies, the determination of the amount of OTTI varies by investment type and is based upon management s periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. Management considers a wide range of factors about the security issuer and uses their best judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for near- term recovery. Inherent in management s evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Management updates its evaluations regularly and reflects additional impairments in net income as determinations are made. Management s determination of the amount of the impairment taken on investments is highly subjective and could adversely impact the Company s results of operations. There can be no assurance that management has accurately assessed the level of OTTI taken and reflected in the Company s financial statements. Furthermore, additional impairments may need to be taken in the future. Historical trends may not be indicative of future impairments.

Levels of write down or OTTI are also impacted by the Company s assessment of the intent to sell securities which have declined in value. If, due to changes in circumstances, the Company determines to reposition or realign portions of the portfolio where the Company decides to sell certain securities in an unrealized loss position, then the Company will incur OTTI charges, which charges could be significant.

Fair Value Measurements of Assets and Liabilities

As disclosed in Note 3 to the Consolidated Financial Statements, Fair Value Measurements , effective January 1, 2008, the Company adopted the authoritative guidance on fair value measurements and has accordingly provided required disclosures by level within the fair value hierarchy of the Company s assets and liabilities that are carried at fair value. As defined in the hierarchy, those assets and liabilities categorized as Level 3 have valuations determined using unobservable inputs. Unobservable inputs may include the entity s own assumptions about market participant assumptions, applied to a modeled valuation, however, this is not the case with respect to the Company s Level 3 assets and liabilities. The vast majority of the assets and liabilities classified as Level 3 are made up of those securities for which the values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker were not obtained to support a Level 2 classification or the Company utilized internal valuation models.

At December 31, 2009, certain assets which were previously classified as Level 3 assets due to a lack of observable market data are now classified as Level 2 assets due to sufficient market data now being available to determine a price and to allow the use of broker quotes.

During the fourth quarter of 2008, the Company determined that for certain of its CDOs with a fair value of $483.2 million and a par value of $801.5 million, the Company considered the recent trading activity to be stressed transactions. The markets for CDOs had become extremely illiquid due to a number of factors including risk aversion and reduction of purchases among institutional buyers. As a result, the Company believed that broker bids reflected loss expectations that did not reflect fair values at which willing buyers and sellers would transact. The Company determined that internal models were more appropriate and better representative of the fair value at which these securities would be sold in an orderly market.

As a result of numerous recent market factors, including increased volumes of trading, the Company believes that transactions in this market are no longer distressed and, accordingly, has reverted to third-party vendor pricing sources where transactions are available as of December 31, 2009, and, where not available, broker quotes. Accordingly, as at December 31, 2009, for those CDOs which were previously valued using internal models, the Company now carries

these assets at a fair value of $538.5 million and a par value of $789.1 million. Of these holdings, $457.6 million were valued by third party vendors and, accordingly, are now classified as Level 2, and $80.9 million were valued using broker quotations and, accordingly, remain classified as Level 3.

Controls over Valuation of Financial Instruments

The Company performs quarterly 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 to gain comfort include, but are not limited to, comparing valuations between external sources and completing recurring reviews of third party pricing services methodologies. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon available market data, the price received from one third party may be substituted for another, or, in limited circumstances, management may determine that an adjustment is required to a third party value. In addition, similar valuation controls are followed by external parties responsible for sourcing appropriate valuations from third parties on the Company s behalf, which provides additional comfort over the reasonableness of the fair values recorded in the Company s financial statements.

Valuation Methodology of Level 3 Assets and Liabilities

Refer to Notes 2 and 3 of the Consolidated Financial Statements, Significant Accounting Policies and Fair Value Measurements for a description of the valuation methodology utilized to value Level 3 assets and liabilities, how the valuation methodology is validated as well as further details associated with various assets classified as Level 3. As at December 31, 2009, the Company did not have any liabilities that were carried at fair value based on Level 3 inputs other than derivative instruments in a liability position at December 31, 2009.

Fair Value of Level 3 Assets and Liabilities

At December 31, 2009, the fair value of Level 3 assets and liabilities as a percentage of the Company s total assets and liabilities that are carried at fair value was as follows:

(U.S. dollars in thousands)	**Total Assets and Liabilities Carried at Fair Value at December 31, 2009**	**Fair Value of Level 3 Assets and Liabilities**	**Level 3 Assets and Liabilities as a Percentage of Total Assets and Liabilities Carried at Fair Value, by class**
Assets			
Fixed maturities, at fair value			
U.S. Government and Government agency-Related/Supported	$ 2,664,625	$	%
Corporate	9,799,000	10,311	0.1 %
Residential mortgage-backed securities Agency	6,228,501	7,894	0.1 %
Residential mortgage-backed securities Non-Agency	1,421,315	42,190	3.0 %
Commercial mortgage-backed securities	1,216,799	2,755	0.2 %
Collateralized debt obligations	698,561	190,663	27.3 %
Other asset-backed securities	1,167,985	38,179	3.3 %
U.S. States and political subdivisions of the States	913,473		%
	3,401,773	3,217	0.1 %

Non-U.S. Sovereign Government, Supranational and Government-Related					
Total Fixed maturities, at fair value		27,512,032		295,209	1.1 %
Equity securities, at fair value		17,779			%
Short-term investments, at fair value		1,777,360		6,486	0.4 %
Total investments available for sale	$	29,307,171	$	301,695	1.0 %
Cash equivalents (1)		2,633,206			%
Other investments (2)		417,589		75,584	18.1 %
Other assets (3)		84,447		185,455	219.6 %
Total assets carried at fair value	$	32,442,413	$	562,734	1.7 %
Liabilities					
Financial instruments sold, but not yet purchased (4)	$	36,979	$		%
Other liabilities (5)		59,958		84,940	141.7 %
Total liabilities carried at fair value	$	96,937	$	84,940	87.6 %

(1) Cash equivalents balances subject to fair value measurements include certificates of deposit and money market funds.

(2) The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation (as described in Note 11, Other Investments), and has provided liquidity financing to a structured credit vehicle as a part of a third party medium term note facility. These investments are carried at amortized cost that totaled $365.6 million at December 31, 2009 and

$94.8 million at December 31, 2008.

(3) Other assets include derivative instruments, reported on a gross basis.

(4) Financial instruments sold, but not yet purchased are included within Net payable for investments purchased on the balance sheet.

(5) Other liabilities include derivative instruments, reported on a gross basis.

As at December 31, 2009, the balance of Level 3 assets as a percentage of the Company s total assets that were carried at fair value was 1.7%. The comparable percentage at December 31, 2008 was 4.5%. The decrease was primarily as a result of a change in the mix of assets during 2009. During 2009, the Company recorded the fair value of CDO holdings based upon pricing service valuations where available due to increased volumes of trading and increased new issuance of CDOs, resulting in transfers being recorded from Level 3 to Level 2.

Changes in the Fair Value of Level 3 Assets and Liabilities

See Note 3 of the Consolidated Financial Statements, Fair Value Measurements , for an analysis of the change in fair value of Level 3 Assets and Liabilities.

Unpaid Losses and Loss Expenses

Unpaid losses and loss expenses reserves relate primarily to the casualty insurance and reinsurance business written by the Company. The balance was $20.8 billion at December 31, 2009, which is a decrease of $0.8 billion from December 31, 2008. The decrease was due primarily to favorable prior year reserve development reducing losses and loss expenses incurred during 2009 and the impact of foreign exchange rate movements.

The table below presents a reconciliation of the Company s unpaid losses and loss expenses for the year ended December 31, 2009:

(U.S. dollars in thousands)	**Gross unpaid losses and loss expenses**	**Unpaid losses and loss expenses recoverable**	**Net unpaid losses and loss expenses**
Balance at December 31, 2008	$ 21,650,315	$ (3,964,836)	$ 17,685,479
Losses and loss expenses incurred	3,990,455	(821,618)	3,168,837
Losses and loss expenses paid/recovered (1)	(5,138,951)	1,263,016	(3,875,935)
Foreign exchange and other	321,705	(33,953)	287,752
Balance at December 31, 2009	$ 20,823,524	$ (3,557,391)	$ 17,266,133

(1) Includes paid losses relating to loss reserves associated with previous reinsurance agreements with Syncora that were settled as part of the Master Agreement.

While the Company reviews the adequacy of established reserves for unpaid losses and loss expenses regularly, no assurance can be given that actual claims made and payments related thereto will not be in excess of the amounts reserved. In the future, if such reserves develop adversely, such deficiency would have a negative impact on future results of operations. See Unpaid Losses and Loss Expenses and Critical Accounting Policies and Estimates above and Item 8, Note 12 to the Consolidated Financial Statements, Losses and Loss Expenses , for further discussion.

Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. While reinsurance agreements are designed to limit the Company s losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve the Company of its ultimate liability to the Company s insureds. Accordingly, the losses and loss expense reserves on the balance sheet represent the Company s total unpaid gross losses. Unpaid losses and loss

expense recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

Unpaid losses and loss expense recoverables were $3.7 billion and $4.0 billion at December 31, 2009, and 2008, respectively. At December 31, 2009 and 2008, reinsurance balances receivable were $0.5 billion and $0.6 billion, respectively. The table below presents the Company s net reinsurance recoverable and reinsurance balances receivable at December 31, 2009 and 2008:

(U.S. dollars in thousands)	December 31, 2009	December 31, 2008
Reinsurance balances receivable	$ 454,660	$ 636,284
Reinsurance recoverable on future policy benefits	26,637	32,886
Reinsurance recoverable on unpaid losses and loss expenses	3,667,344	4,079,860
Bad debt reserve on unpaid losses and loss expenses recoverable and reinsurance balances receivable	(189,769)	(187,614)
Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable	$ 3,958,872	$ 4,561,416

The Company has credit risk should any of its reinsurers be unable or unwilling to settle amounts due. Of the $4.0 billion total unpaid losses and loss expenses recoverable and reinsurance balances receivable at December 31, 2009, one individual reinsurer accounted for 15% or more of the total. The Company is the beneficiary of letters of credit, trust accounts and funds withheld in the aggregate amount of $1.7 billion at December 31, 2009, collateralizing reinsurance recoverables with respect to certain reinsurers. The provision for uncollectible reinsurance is required principally due to the failure of reinsurers to indemnify the Company primarily because of disputes under reinsurance contracts and insolvencies. As at December 31, 2009 and 2008, the Company had a reserve for potential non-recoveries from reinsurers of $189.8 million and $187.6 million, respectively.

Approximately 88% of the total unpaid loss and loss expense recoverable and reinsurance balances receivable (excluding collateral held) outstanding at December 31, 2009, were due from reinsurers rated A or better by S&P. The following is an analysis of the total recoverable and reinsurance balances receivable at December 31, 2009, by reinsurers owing more than 3% of such total:

Name of reinsurer	S&P s rating	% of total
Munich Reinsurance Company	AA-/Stable	17.3%
Swiss Reinsurance Company	A+/Stable	10.9%
Lloyd s Syndicates	A+/Stable	6.3%
Swiss Re Europe S.A.	A+/Stable	4.4%
Transatlantic Reinsurance Company	A+/Stable	4.1%

The following table sets forth the ratings profile of the reinsurers that support the unpaid loss and loss expense recoverable and reinsurance balances receivable:

Standard and Poor s rating	% of total

AAA.	4.9 %
AA	33.3 %
A	49.5 %
BBB	0.8 %
BB and below	%
Captives	8.4 %
Not Rated	0.3 %
Other	2.8 %
Total	100.0 %

Liquidity and Capital Resources

Liquidity is a measure of the Company s ability to generate sufficient cash flows to meet the short- and long-term cash requirements of the Company s business operations.

As a global insurance and reinsurance company, one of the Company s principal responsibilities to its clients is to ensure that the Company has ready access to funds with which to settle large unforeseen claims. The Company would generally expect that positive cash flow from operations (underwriting activities and investment income) will be sufficient to cover cash outflows under most future loss scenarios. However, there is a possibility that unforeseen demands could be placed on the Company due to extraordinary events and as such the Company s liquidity needs may change. Such events include, among other things, several significant catastrophes occurring in a relatively short period of time resulting in material incurred losses; rating agency downgrades of the Company s core insurance and reinsurance subsidiaries that would require posting of collateral, return of unearned premium and/or the settlement of derivative transactions; large scale uncollectible reinsurance recoverables on paid losses (as a result of coverage disputes, reinsurers credit problems or decreases in the value of collateral supporting reinsurance recoverables), etc. Any one or a combination of such events may cause a liquidity strain for the Company. In addition, a liquidity strain could also occur in an illiquid market, such as that which was experienced in 2008. Investments that may be used to meet liquidity needs in the event of a liquidity strain may not be liquid, given inactive markets, or may have to be sold at a significant loss as a result of depressed prices. Because each subsidiary focuses on a more limited number of specific product lines than is collectively available from the consolidated group of companies, the mix of business tends to be less diverse at the subsidiary level. As a result, the probability of a liquidity strain, as described above, may be greater for individual subsidiaries than when liquidity is assessed on a consolidated basis. If such a liquidity strain were to occur in a subsidiary, XL Capital Ltd may be required to contribute capital to the particular subsidiary and/or curtail dividends from the subsidiary to support holding company operations.

A downgrade below A- of the Company s principal insurance and reinsurance subsidiaries by either S&P or A.M. Best, which is two notches below the current S&P financial strength rating of A (Negative) and the A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger cancellation provisions in a significant amount of the Company s assumed reinsurance agreements and may potentially require the Company to return unearned premiums to cedants. In addition, due to collateral posting requirements under the Company s letter of credit and revolving credit facilities, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities. Specifically, a downgrade below A- by A.M. Best would trigger such collateral requirements for the Company s largest credit facility. In certain limited instances, such downgrades may require the Company to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1, Business Ratings, for further information. See Item 1A, Risk Factors, A downgrade or potential downgrade in our financial strength and credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations and/or liquidity.

Holding Company Liquidity

As a holding company, XL Capital Ltd has no operations of its own and its assets consist primarily of its investments in its subsidiaries. Accordingly, XL Capital Ltd s future cash flows largely depend on the availability of dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries and states in which XL Capital Ltd s subsidiaries operate, including, among others, Bermuda, New York, Ireland, Switzerland and the United Kingdom. See Item 8, Note 26 to the Consolidated Financial Statements, Statutory Financial Data , for further discussion and details regarding dividend capacity of the Company s major operating subsidiaries. See Risk Factors Risks Related to the Company because we are a holding company, if our subsidiaries do not make dividend and other payments to us, we may not be able to pay dividends or make payments on our debt securities and other obligations in Item 1A. The ability to pay such dividends is also limited by the regulations of the Society of Lloyd s and certain contractual provisions. No assurance can be given that the Company s subsidiaries will pay dividends in the future to XL Capital Ltd.

During 2009, management changed the internal ownership structure of certain of the Company s operating subsidiaries in Bermuda and Ireland in order to more efficiently utilize capital and to improve overall liquidity. In connection with these changes, certain dividends were paid to XL Capital Ltd by operating subsidiaries. As at December 31, 2009, the Holding Company, XL Capital Ltd, had cash and

investments of $1.5 billion compared to $0.1 billion at December 31, 2008 (net of liabilities associated with cash sweeping arrangements).

XL Capital Ltd s principal uses of liquidity are for dividend payments to holders of its ordinary shares and preferred shares, interest and principal payments on debt, capital investments in its subsidiaries and corporate operating expenses.

XL Capital Finance (Europe) plc (XLFE) is a wholly owned finance subsidiary of the XL Capital Ltd. In January 2002, XLFE issued $600 million par value 6.5% Guaranteed Senior Notes due January 2012. These notes are fully and unconditionally guaranteed by XL Capital Ltd.

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

See Consolidated Statements of Cash Flows in Item 8, Financial Statements and Supplementary Data.

Sources of Liquidity for the Company

As at December 31, 2009, the consolidated Company had cash and cash equivalents of approximately $3.6 billion as compared to approximately $4.4 billion at December 31, 2008. There are three main sources of cash flows for the Company those provided by operations, investing activities and financing activities.

Operating Cash Flows

Historically, cash receipts from operations, consisting of premiums and investment income, generally have provided sufficient funds to pay losses as well as operating expenses of the Company s subsidiaries and to fund dividends to XL Capital Ltd. However, as a result of the combination of current soft market conditions, the decision to put the life segment and certain P&C lines into run-off and lower investment yields, operating cash flows excluding extraordinary events are expected to be lower than prior years. Cash receipts from operations is generally derived from the receipt of investment income on the Company s investment portfolio as well as the net receipt of premiums less claims and expenses related to the Company s underwriting activities in its property and casualty operations as well as its Life Operations segment. The Company s operating subsidiaries provide liquidity in that premiums are generally received months or even years before losses are paid under the policies related to such premiums. Premiums and acquisition expenses are settled based on terms of trade as stipulated by an underwriting contract, and generally are received within the first year of inception of a policy when the premium is written, but can be up to three years on certain reinsurance business assumed. Operating expenses are generally paid within a year of being incurred. Claims especially for casualty business, may take a much longer time before they are reported and ultimately settled, requiring the establishment of reserves for unpaid losses and loss expenses. Therefore, the amount of claims paid in any one year is not necessarily related to the amount of net losses incurred, as reported in the consolidated statement of income.

During the year ended 2009, net cash flows used in operating activities were $42.8 million. This net cash outflow resulted primarily because lower premium levels did not offset the payment of claims. In addition, investment income during 2009 was significantly lower as a result of lower average invested balances and lower overall yields.

During the year ended 2008, net cash flows used in operating activities were $427.3 million primarily as a result of the payment of approximately $1.8 billion to Syncora under the Master Agreement. The Company funded the payment to Syncora by using proceeds from the offering of both ordinary shares and ESUs, as well as from the proceeds received following the exercise by the Company of the put option under its Mangrove Bay contingent capital facility as described below. Excluding the payment to Syncora, net cash flows from operations was approximately $1.3 billion in 2008. For the same period in 2007, net cash flows from operations was $2.2 billion. The decrease in net cash flow

from operations, excluding the payment to Syncora, was primarily a result of decreases in net premiums written in the Company s P&C operations as described above and of lower net investment income related to both P&C operations and structured products mainly due to a lower asset base and changes in the portfolio mix following the sale of assets used to settle the GIC liabilities. In addition, yields earned on investment of cash flows and

reinvestment of maturing or sold securities have decreased, as prevailing market interest rates, in most major geographies, have decreased overall during the last twelve months.

Total net paid losses were $3.9 billion in 2009 and $3.8 billion in each of 2008 and 2007, respectively. Net losses incurred were $3.2 billion, $4.0 billion and $3.8 billion in 2009, 2008 and 2007, respectively.

Investing Cash Flows

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

Net cash provided by investing activities of $214.6 million in 2009 was mainly associated with normal purchase and sale of portfolio investments. During the year, the Company redeemed $441.5 million of alternative fund investments.

Net cash provided by investing activities of $3.8 billion in 2008 was mainly associated with the sale and redemption of the Company s investments in fixed maturities, short-term investments and equity securities. The sales of such securities exceeded related purchases, due mainly to the sale of assets used to settle the GIC liabilities and as a result of the Company s intention to reposition its investment portfolio and increase its holdings of cash as well as government agency holdings.

Net cash used in investing activities in 2007 was primarily related to the purchase and sale of portfolio investments, with purchases of investments exceeding the related sales and redemptions. In addition, in 2007, the Company sold a portion of its interest in Syncora, through a secondary offering for $316.3 million. However, as a result of the sale and subsequent deconsolidation of Syncora, investing cash flows were reduced by $110.8 million.

Certain of the Company s invested assets are held in trust and pledged in support of insurance and reinsurance liabilities. 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. In addition certain deposit liabilities and annuity contracts require the use of pledged assets. As at December 31, 2009 and 2008, the Company had $16.7 billion and $13.7 billion in pledged assets, respectively.

Financing Cash Flows

Cash flows related to financing activities include ordinary and preferred share related transactions, the payment of dividends, the issue or repayment of debt and deposit liability transactions.

During the year ended December 31, 2009, net cash flows used in financing activities were $962.6 million. Net cash outflows relate primarily to the repayment of debt and deposit liabilities and the payment of common and preferred dividends.

Following the settlement of the purchase contracts associated with the 7.0% ESUs in February 2009, the Company issued 11,461,080 Shares for net proceeds of approximately $743.1 million, which was used to retire the senior notes previously due February 2011, which had a fixed coupon of 5.25%.

On March 26, 2009, the Company completed a cash tender offer for its outstanding Series C Preference Ordinary Shares that resulted in approximately 12.7 million Series C Preference Ordinary Shares with a liquidation value of $317.3 million being purchased by the Company for approximately $104.7 million plus accrued and unpaid dividends, combined with professional fees totaling $0.8 million. As a result, a book value gain of approximately $211.8 million was recorded in the first quarter of 2009 to ordinary shareholders.

In the year ended December 31, 2008, net cash flows used in financing activities was $2.8 billion. The main drivers for the cash outflow in 2008 are summarized below.

In order to fund the payment of approximately $1.8 billion to Syncora under the Master Agreement and the payment of approximately $283 million to consummate the redemption of X.L. America, Inc. s 6.58% Notes, the Company raised approximately $2.8 billion in August 2008 through an issuance of both ordinary shares and ESUs. Concurrent with the execution of the Master Agreement, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003, resulting in net

proceeds to the Company of approximately $500 million in exchange for the issuance by the Company of 20,000,000 Series C Preference Ordinary Shares, par value U.S. $0.01 per share (the Series C Preference Shares). For further details on these transactions, see Capital Resources , below.

In July 2008, in conjunction with the issuance of ordinary shares and ESUs described above, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.19 per ordinary share beginning with the quarterly dividend paid in September 2008. In addition, in February 2009, the Board of Directors approved a further reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend payable in March 2009.

As noted above, the Company settled during 2008 approximately $4.0 billion of GIC liabilities through the sale of certain assets from its fixed income portfolio. In addition, $1.2 billion of funding agreements were settled during 2008. At December 31, 2008, a significant component of the investments held in the Company s Other Financial Lines segment portfolios was comprised of Topical Assets and CDOs. Liquidations necessary to fund the repayment of the GIC liabilities following the downgrade of Syncora Guarantee and the maturity of certain funding agreements were funded through sales of assets in these portfolios as well as the general investment portfolios. Management s approach was to avoid the sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold a number of the Topical Assets and CDOs, which were transferred to the general investment portfolio in exchange for those assets that were liquidated. At December 31, 2009, the remaining balance of funding agreements, excluding accrued interest of $6.5 million, was $450 million, with the full balance scheduled for settlement in August 2010. The Company continues to manage its liquidity needs through changes in the mix of its investment portfolio as well as through other available capital resources and lines of credit as noted below.

In 2007, the Company repurchased approximately $1.1 billion of ordinary shares through its share repurchase programs and issued approximately $825.0 million of ordinary shares in connection with the maturity of the purchase contracts associated with the 6.5% Equity Security Units. In addition, the Company issued Series E preference ordinary shares for $1 billion and redeemed both its Series A and Series B preference ordinary shares for $230.0 million and $287.5 million, respectively. With regards to debt transactions in 2007, the Company purchased and retired the 2009 Senior Notes for $825.0 million in connection with the 6.5% Units and issued the 2027 Senior Notes for gross proceeds of approximately $324.4 million. In 2007, dividends paid were $274.0 million for ordinary shares and $69.5 million for preferred shares. In 2007, the Company paid out $360.0 million of net cash relating to deposit liability contracts.

The Company is considered a Well Known Seasoned Issuer (WKSI) under the rules of the SEC. The Company maintains a shelf registration statement on Form S-3 and is eligible for automatically effective future registration statements for the potential offering and sale of an unlimited amount of debt and equity securities. The Registration Statement allows for the following types of securities to be offered: (i) debt securities, preferred stock, common stock, depositary shares, warrants, stock purchase contracts, stock purchase units and junior subordinated deferrable interest debentures of the Company, (ii) preferred securities of any of one or more capital trusts organized by the Company and guarantees of such securities by the Company and (iii) debt securities of XL Capital Finance (Europe) plc and guarantees of such securities by the Company.

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

Capital Resources

At December 31, 2009 and 2008, the Company had total shareholders equity of $9.4 billion and $6.1 billion, respectively. In addition to ordinary share capital, the Company depends on external sources of financing to support its underwriting activities in the form of:

a. debt;

b. preference shares;

c. contingent capital; and

d. letter of credit facilities and other sources of collateral.

In particular, the Company requires, among other things:

sufficient capital to maintain its financial strength and credit ratings, as issued by several ratings agencies, at levels considered necessary by management to enable the Company s key operating subsidiaries to compete;

sufficient capital to enable its regulated subsidiaries to meet the regulatory capital levels required in the U.S., the U.K., Bermuda, Ireland, Switzerland

and other key markets;

letters of credit and other forms of collateral that are required to be posted or deposited, as the case may be, by the Company s operating subsidiaries that are non-admitted under U.S. state insurance regulations in order for the U.S. cedant to receive statutory credit for reinsurance. The Company also uses letters of credit to support its operations at Lloyd s; and

revolving credit to meet short-term liquidity needs.

The following risks are associated with the Company s requirement to renew its credit facilities:

the credit available from banks may be reduced resulting in

the Company s need to pledge its investment portfolio to customers. This could result in a lower investment yield;

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

the volume of business that the Company s subsidiaries that are not admitted in the U.S. are able to transact could be reduced if the Company is unable to renew its

letter of
credit
facilities at
an
appropriate
amount.

Continued consolidation within the banking industry may result in the aggregate amount of credit provided to the Company being reduced. The Company attempts to mitigate this risk by identifying and/or selecting additional banks that can participate in the credit facilities upon renewal.

The following table summarizes the components of the Company s current capital resources at December 31, 2009 and 2008:

(U.S. dollars in thousands)	**December 31, 2009**	**December 31, 2008**
Preferred share capital	$ 1,182,673	$ 1,500,000
Ordinary share capital	8,432,417	5,116,831
Total Ordinary and Preferred capital	$ 9,615,090	$ 6,616,831
Notes payable and debt	2,445,733	3,189,734
Total capital	$ 12,060,823	$ 9,806,565

a) Ordinary Share Capital

The following table reconciles the opening and closing common equity positions at December 31, 2009 and 2008:

(U.S. dollars in thousands)	**December 31, 2009**	**December 31, 2008**
Ordinary share equity beginning of period	$ 5,116,831	$ 8,950,561
Net income (loss) attributable to XL Capital Ltd	74,991	(2,553,813)
Share repurchases	(626)	(4,966)
Share issues	741,291	2,388,561
Common share dividends	(136,804)	(261,464)
Preferred share dividends	(80,200)	(78,645)
Gain on redemption of Series C preference ordinary shares	211,816	
Change in accumulated other comprehensive income	2,222,460	(3,374,086)
Impact of adoption of new authoritative OTTI guidance, net of tax	229,670	
Share based compensation and other	52,988	50,683
Ordinary equity end of period	$ 8,432,417	$ 5,116,831

b) Debt

The following tables present the Company s debt under outstanding securities and lenders commitments as at December 31, 2009:

Notes Payable and Debt *(U.S. dollars in thousands)*	**Commitment/ Debt**	**In Use/ Outstanding**	**Year of Expiry**	**Payments Due by Period** **Less than 1 Year**	**1 to 3 Years**	**3 to 5 Years**	**A**
5-year revolvers (1)	$ 1,000,000	$	2010/2012	$	$	$	$
5-year revolver	100,000		2010				
6.50% Guaranteed Senior Notes	600,000	599,350	2012		600,000		
5.25% Senior Notes	600,000	596,933	2014			600,000	
8.25% Senior Notes	575,000	575,000	2021				
6.375% Senior Notes	350,000	350,000	2024				
6.25% Senior Notes	325,000	324,450	2027				
	$ 3,550,000	$ 2,445,733		$	$ 600,000	$ 600,000	$

In Use and Outstanding data represent December 31, 2009 accreted values. Payments Due by Period data represent ultimate redemption values.

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(1) The 2010 and 2012 5-year revolving

credit facilities share a $1.0 billion revolving credit sublimit.

In addition, see Note 16 to the Consolidated Financial Statements, Notes Payable and Debt Financing Arrangements for further information.

At December 31, 2009, banks and investors provided the Company and its subsidiaries with $3.5 billion of debt capacity, of which $2.4 billion was utilized by the Company. These facilities consist of:

revolving credit facilities of $1.1 billion in aggregate.

senior Unsecured Notes of approximately $2.4 billion. These notes require the Company to pay a fixed rate of interest during their terms. At December 31, 2009, there were five outstanding issues of senior unsecured notes:

$600 million senior notes due January 2012, with a fixed coupon of 6.5%. The security is publicly traded. The notes were

issued at $99.469 and gross proceeds were $596.8 million. Related expenses of the offering amounted to $7.9 million.

$600 million senior notes due September 2014, with a fixed coupon of 5.25%. The security is publicly traded. The notes were issued in two tranches of $300 million aggregate principal amount each one tranche at 99.432% and the other at 98.419%. Aggregate gross proceeds were $593.6 million. Related expenses of the offering amounted to $4 million.

$575 million of senior notes due August 2021, with a fixed coupon of 8.25%. These securities are a component of

the 10.75% Units that are publicly traded. In addition to the coupon paid on the senior notes, quarterly contract adjustment payments at an annual rate of 2.50% per annum are paid on forward purchase contracts for the Company s common shares for a total distribution of 10.75% per annum. The purchase contracts mature in 2011, and the senior notes mature in 2021. In August 2011, the senior notes will be remarketed whereby the interest rate will be reset in order to generate sufficient remarketing proceeds to satisfy the 10.75% Unit holders obligations under the purchase

contract.

$350 million senior notes due November 2024, with a fixed coupon of 6.375%. The security is publicly traded. The notes were issued at 100.0% and gross proceeds were $350 million. Related expenses of the offering amounted to $2 million.

$325 million of senior notes due 2027, with a fixed coupon of 6.25%. The security is publicly traded. The notes were issued at 99.805% and gross proceeds were $324.4 million. Related expenses of the offering amounted to $2.5 million.

c) Preferred shares

As at December 31, 2009 the Company s preferred share capital is made up of $1.0 billion Series E Preference ordinary shares and $182.7 million Series C Preference ordinary shares. As at December 31,

2008 the company s preferred share capital is made up of $1.0 billion Series E Preference ordinary shares and $500 million Series C Preference ordinary shares.

On March 26, 2009, the Company completed a cash tender offer for its outstanding Series C Preference Ordinary Shares that resulted in approximately 12.7 million Series C Preference Ordinary Shares with a liquidation value of $317.3 million being purchased by the Company for approximately $104.7 million plus accrued and unpaid dividends, combined with professional fees totaling $0.8 million. As a result, a book value gain of approximately $211.8 million was recorded in the first quarter of 2009 to ordinary shareholders. In addition, see Note 21 to the Consolidated Financial Statements, Share Capital for further information.

d) Contingent Capital

At December 31, 2009, the Company has one contingent capital transaction where the outstanding put option has not been exercised. No up-front proceeds were received by the Company under this transaction. In the event that the associated irrevocable put option agreement is exercised, proceeds previously raised from investors from the issuance of pass-through trust securities would be received in return for the issuance of preferred shares. See below for further details on this transaction.

On December 5, 2006, the Company and certain operating subsidiaries (Ceding Insurers) entered into a securities issuance agreement (the Securities Issuance Agreement), and certain of the Company s foreign insurance and reinsurance subsidiaries (Ceding Insurers) entered into an excess of loss reinsurance agreement (the Reinsurance Agreement), with Stoneheath Re (Stoneheath). The net effect of these agreements to the Company is the creation of a contingent put option to issue $350.0 million of preference ordinary shares in the aggregate. The agreements provide the Company with a Reinsurance Collateral Account in support of certain covered perils named in the Reinsurance Agreement. The covered perils include United States wind, European wind, California earthquake and terrorism worldwide. After an initial three-month period, the covered perils as well as the attachment points and aggregate retention amounts may be changed by the Ceding Insurers in their sole discretion. This may result in a material increase or decrease in the likelihood of payment under the Reinsurance Agreement. On each date on which a Ceding Insurer withdraws funds from the Reinsurance Collateral Account, the Company shall issue and deliver to Stoneheath an amount of XL Capital Ltd Series D Preference Shares (the XL Preferred Securities) having an aggregate liquidation preference that is equal to the amount of funds so withdrawn from the Collateral Account. The Company is obligated to reimburse Stoneheath for certain fees and ordinary expenses. The initial term of the Reinsurance Agreement was for the period from the Closing Date through June 30, 2007, with four annual mandatory extensions through June 30, 2011 (unless coverage is exhausted thereunder prior to such date). The Ceding Insurers may thereafter extend the Reinsurance Agreement at their option for additional calendar quarters without limit (unless coverage is exhausted thereunder). The contingent put option is recorded at fair value with changes in fair value recognized in earnings. The XL Preferred Securities, if issued, will pay dividends on a non-cumulative basis at a fixed rate of 6.868% per annum through October 15, 2011 and thereafter at a floating rate based on 3-month LIBOR, plus 3.12%.

e) Letter of Credit Facilities and other sources of collateral

At December 31, 2009, the Company had six letter of credit facilities in place with total availability of $7.25 billion, of which $3.0 billion was utilized.

Other Commercial Commitments *(U.S. dollars in thousands)*	**Commitment**	**In Use**	**Year of Expiry**	**Amount of Commitment Expiration per period** **Less than 1 Year**	**1 to 3 Years**	**3 to 5 Years**

Letter of Credit Facility	$ 250,000	143,591	Continuous		
Letter of Credit Facility (1)	2,250,000		2010	2,250,000	
Letter of Credit Facility (1)	4,000,000	2,369,092	2012		4,000,000
Letter of Credit Facility	137	137	Continuous		
Letter of Credit Facility	93	93	Continuous		
Letter of Credit Facility	750,000	499,256	Continuous		
Six letter of credit facilities	$ 7,250,230	$ 3,012,169		$ 2,250,000	$ 4,000,000

(1) Of the total letter of credit facilities above, $1 billion is also included in the revolvers under notes payable and debt.

In the event that such credit support is insufficient, the Company could be required to provide alternative security to cedants. This could take the form of insurance trusts supported by the Company s investment portfolio or funds withheld (amounts retained by ceding companies to collateralize loss or premium reserves) using the Company s cash resources or combinations thereof. The face amount of letters of credit required is driven by, among other things, loss development of existing reserves, the payment pattern of such reserves, the expansion of business written by the Company and the loss experience of such business. In addition to letters of credit, the Company has established insurance trusts in the U.S. that provide cedants with statutory credit for reinsurance under state insurance regulation in the U.S.

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

The following letter of credit facilities were originated, renewed or terminated during 2009:

On December 14, 2009, the £450 million letter of credit facility issued on November 14, 2007 that was supporting the Company s syndicates at Lloyd s of London terminated. This was replaced by a $750 million bilateral secured letter of credit facility.

Covenants

The Company s Credit Facilities contains a number of financial covenants that must be met and maintained, and that among other things, could restrict, subject to certain exceptions, our financial flexibility including the ability to:

- engage in mergers or consolidations;
- dispose of assets out with the ordinary course of business;
- create liens on assets; and
- engage in certain transactions with affiliates.

The following outlines the covenant requirements and actual amounts as of December 31, 2009:

	Covenant Requirement	Actual Ratio or Balance at December 31, 2009	Margin of Adverse Development from December 31, 2009 Levels
	Less than 0.35:1.00	0.19:1.00	$4.6 billion

Ratio of Total Funded Debt to Total Capitalization (1)			
Maximum Secured Indebtedness (2)	Less than 15% of consolidated net worth	0%	$1.6 billion
Consolidated Net Worth (3)	$6.4 billion	$10.6 billion	$4.2 billion
Financial Strength Ratings (4)	Better than B++ from A.M. Best	A (stable)	Two notch downgrade

(1) The ratio of total funded debt to total capitalization not to be greater than 0.35:1.00. This ratio is defined as total funded debt to the sum of total funded debt plus consolidated net worth.

(2) Secured indebtedness excludes secured letter of credit facilities as permitted under the schedules to the credit facilities. At December 31, 2009, such secured letter of credit facilities amounted to $642.8 million.

(3)

Consolidated net worth means, at any time, the consolidated stockholders equity of the Company excluding (a) the effect of any adjustments required under the authoritative accounting guidance for accounting for certain investments in debt and equity securities; and (b) any exempt indebtedness (and the assets relating thereto) in the event such exempt indebtedness is consolidated on the consolidated balance sheet the Company.

(4) Covenants require that, none of the XL Capital Group, XL Insurance (Bermuda) Ltd or XL Re Ltd have financial strength ratings of less

than A- from A.M. Best. The financial strength ratings as at December 31, 2009 were XL Capital Group, A (Stable), XL Insurance (Bermuda) Ltd A (Stable) and XL Re Ltd A (Stable).

As noted in the table above, at December 31, 2009, the Company was in compliance with all covenants by significant margins and the Company currently remains in compliance.

Cross-Default and Other Provisions in Debt Instruments

The following describes certain terms of the documents referred to below. All documents referred to below have been filed with the SEC and should be referred to for an assessment of the complete contractual obligations of the Company.

In general, all of the Company s bank facilities, indentures and other documents relating to the Company s outstanding indebtedness, including the credit facilities discussed above (collectively, the Company s Debt Documents), contain cross default provisions to each other and the Company s Debt Documents contain affirmative covenants. These covenants provide for, among other things, minimum required ratings of the Company s insurance and reinsurance operating subsidiaries and the level of secured indebtedness in the future. In addition, generally each of the Company s Debt Documents provide for an event of default in the event of a change of control of the Company or some events involving bankruptcy, insolvency or reorganization of the Company.

A downgrade below A- of the Company s principal insurance and reinsurance subsidiaries by either S&P or A.M. Best, which is two notches below the current S&P financial strength rating of A (Negative) and the A.M. Best financial strength rating of A (Stable) of these subsidiaries, may trigger cancellation provisions in a significant amount of the Company s assumed reinsurance agreements and may potentially require the Company to return unearned premiums to cedants. In addition, due to collateral posting requirements under the Company s letter of credit and revolving credit facilities, such a downgrade may require the posting of cash collateral in support of certain in use portions of these facilities (see Liquidity and Capital Resources). Specifically, a downgrade below A- by A.M. Best would trigger such collateral requirements for the Company s two largest credit facilities. In certain limited instances, such downgrades may require the Company to return cash or assets to counterparties or to settle derivative and/or other transactions with the respective counterparties. See Item 1A, Risk Factors, A downgrade or potential downgrade in our financial strength and credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations and/or liquidity.

Under the Company s five-year U.S. credit facilities, in the event that the XL Capital Group, XL Insurance (Bermuda) Ltd and XL Re Ltd fail to maintain a financial strength rating of at least A from A.M. Best, an event of default would occur.

The 6.5% Guaranteed Senior Notes indenture contains a cross default provision. In general, in the event that the Company defaults in the payment of indebtedness in the amount of $50.0 million or more, an event of default would be triggered under the Guaranteed Senior Notes indentures. Given that all of the Company s Debt Documents contain cross default provisions, this may result in all holders declaring such debt due and payable and an acceleration of all debt due under those documents. If this were to occur, the Company may not have funds sufficient at that time to repay any or all of such indebtedness.

Long-Term Contractual Obligations

The following table presents the Company s long term contractual obligations and related payments as at December 31, 2009, due by period. This table excludes further commitments of $134.4 million to the Company s related investment funds and certain limited partnerships, and letter of credit facilities of $3.0 billion. See Item 8, Note 17 to the Consolidated Financial Statements, Derivative Instruments, and Note 20 to the Consolidated Financial Statements, Commitments and Contingencies. See Item 8, Note 16 to the Consolidated Financial Statements, Notes Payable and Debt and Financing Arrangements, for further information.

Contractual Obligations *(U.S. dollars in thousands)*	**Total**	**Less than 1 year**	**1 to 3 years**	**3 to 5 years**	**More than 5 years**
Long-term debt obligations	$ 2,450,000	$	$ 600,000	$ 600,000	$ 1,250,000
Interest on long-term debt	947,018	114,943	267,124	160,950	404,001
Contingent capital facilities	33,280	8,320	16,640	8,320	
Equity Units	560,564	49,231	143,692	142,313	225,328
Operating lease obligations	208,596	32,639	57,418	44,286	74,253
Capital lease obligations	257,406	11,116	23,072	24,241	198,977
Deposit liabilities (1)	3,430,711	699,319	304,549	289,440	2,137,403
Future policy benefits (2)	9,017,957	384,095	752,287	769,523	7,112,052
Unpaid losses and loss expenses property and casualty operations (3)	21,218,196	4,368,764	5,799,231	3,474,695	7,575,506
Total	$ 38,123,728	$ 5,668,427	$ 7,964,013	$ 5,513,768	$ 18,977,520

(1) Deposit liabilities on the Company s Consolidated Balance Sheet at December 31, 2009 were $2,208,699. The difference

from the amount included above relates to the discount on payments due in the future. The payment related to these liabilities varies primarily based on interest rates. The ultimate payments associated with these liabilities could differ from the Company s estimate. See Item 8, Note 14 to the Consolidated Financial Statements, Deposit Liabilities, for further information.

(2) Future policy benefit reserves related to Life operations were $5,490,119 on the Company s Consolidated Balance Sheet at December 31, 2009. Amounts reflected above include an allowance

for future premiums in respect of contracts under which premiums are payable throughout the life of the underlying policy. The value of the discount is also included for those lines of business that have reserves where future claim payments and future premium receipts can be estimated using actuarial principles. The timing and amounts of actual claims payments and premium receipts related to these reserves vary based on the underlying experience of the portfolio. Typical elements of the experience include mortality, morbidity and persistency. The ultimate amount of the claims payments and

premium receipts could differ materially from the Company s estimated amounts.

(3) The unpaid loss and loss expenses were $20,823,524 on the Company s Consolidated Balance Sheet at December 31, 2009. The difference from the amount included above relates to the discount on payments due in the future for certain workers compensation lines. The timing and amounts of actual claims payments related to these P&C reserves vary based on many factors including large individual losses, changes in the legal environment, as well as general market

conditions. The ultimate amount of the claims payments could differ materially from the Company s estimated amounts. For information regarding the estimates for unpaid loss and loss expenses as well as factors effecting potential payment patterns of reserves for actual and potential claims related the Company s different lines of business see Critical Accounting Policies and Estimates above. Certain lines of business written by the Company, such as excess casualty, have loss experience characterized as low frequency and high severity. This may result in significant variability in loss payment

patterns and, therefore, may impact the related asset/liability investment management process. In order to be in a position, if necessary, to make these payments, the Company s liquidity requirements are supported by having revolving lines of credit facilities available to the Company and significant reinsurance programs, in addition to the Company s general high grade fixed income investment portfolio.

Variable Interest Entities (VIEs) and Other Off-Balance Sheet Arrangements

At times, the Company has utilized VIEs both indirectly and directly in the ordinary course of the Company s business.

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

The company has a limited number of remaining outstanding credit enhancement exposures including written financial guarantee and credit default swap contracts. The obligations related to these transactions are often securitized through variable interest entities. The Company is not the primary beneficiary of these variable interest entities as contemplated in current authoritative accounting guidance. For further details on the nature of the obligations and the size of the company s maximum exposure see Note 2(r), Recent Accounting Pronouncements , and Note 17, Derivative Instruments .

The Company has utilized variable interest entities in certain instances as a means of accessing contingent capital. The Company has utilized unconsolidated entities in the formation of contingent capital facilities.

On December 5, 2006, the Company and certain operating subsidiaries (Ceding Insurers) entered into a securities issuance agreement (the Securities Issuance Agreement), and certain of the Company s foreign insurance and reinsurance subsidiaries (Ceding Insurers) entered into an excess of loss reinsurance agreement (the Reinsurance Agreement), with Stoneheath Re (Stoneheath). The net effect of these agreements to the Company is the creation of a contingent put option in the amount of $350.0 million in the aggregate. The Company s interests in Stoneheath represents an interest in a variable interest entity under current authoritative accounting guidance, however, the Company is not the primary beneficiary as contemplated in that guidance. Given that there are no contractual requirements or intentions to enter into additional variable interests in this entity; management considers the likelihood of consolidating Stoneheath in the future to be remote.

The agreements provide the Company with a Reinsurance Collateral Account in support of certain covered perils named in the Reinsurance Agreement. The covered perils include United States wind, European wind, California earthquake and terrorism worldwide. After an initial three-month period, the covered perils as well as the attachment points and aggregate retention amounts may be changed by the Ceding Insurers in their sole discretion. This may result in a material increase or decrease in the likelihood of payment under the Reinsurance Agreement. On each date on which a Ceding Insurer withdraws funds from the Reinsurance Collateral Account, the Company shall issue and deliver to the Issuer an amount of XL Capital Ltd Series D Preference Shares having an aggregate liquidation preference that is equal to the amount of funds so withdrawn from the Collateral Account. The Company is obligated to reimburse Stoneheath for certain fees and ordinary expenses. The initial term of the Reinsurance Agreement was for the period from the Closing Date through June 30, 2007, with four annual mandatory extensions thereafter through June 30, 2011 (unless coverage is exhausted there under prior to such date). The Ceding Insurers may thereafter extend the Reinsurance Agreement at their option for additional calendar quarters without limit (unless coverage is exhausted there under). The contingent put option is recorded at fair value with changes in fair value recognized in earnings. The Stoneheath preferred securities and, if issued, the XL Series D Preference Shares will pay dividends on a non-cumulative basis at a fixed rate of 6.868% per annum through October 15, 2011 and thereafter at a floating rate based on 3-month LIBOR, plus 3.12%.

Recent Accounting Pronouncements

See Item 8, Note 2 to the Consolidated Financial Statements, Significant Accounting Policies , for a discussion on recent accounting pronouncements.

Cautionary Note Regarding Forward-Looking Statements

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

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. The Company believes that these factors include, but are not limited to, the following: (i) changes in ratings, rating agency policies or practices; (ii) changes in the size of the Company s claims relating to natural catastrophe losses due to the preliminary nature of some reports and estimates of loss and damage to date; (iii) trends in rates for property and casualty insurance and reinsurance; (iv) the timely and full recoverability of reinsurance placed by the Company with third parties, or other amounts due to the Company; (v) changes in the projected amount of ceded reinsurance

recoverables and the ratings and creditworthiness of reinsurers; (vi) the timing of claims payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company; (vii) ineffectiveness or obsolescence of the

Company s business strategy due to changes in current or future market conditions; (viii) increased competition on the basis of pricing, capacity, coverage terms or other factors; (ix) greater frequency or severity of claims and loss activity than the Company s underwriting, reserving or investment practices anticipate based on historical experience or industry data; (x) the effects of inflation on our business, including on pricing and reserving; (xi) developments, including uncertainties related to the depth and duration of the current recession, and future volatility, in the world s credit, financial and capital markets that adversely affect the performance and valuation of XL s investments or access to such markets; (xii) the potential impact on the Company from government-mandated insurance coverage for acts of terrorism; (xiii) the potential for changes to methodologies, estimations and assumptions that underlie the valuation of the Company s financial instruments that could result in changes to investment valuations; (xiv) changes to the Company s assessment as to whether it is more likely than not that the Company will be required to sell, or has the intent to sell, available for sale debt securities; (xv) developments in bankruptcy proceedings or other developments related to bankruptcies of companies insofar as they affect property and casualty insurance and reinsurance coverages or claims that the Company may have as a counterparty; (xvi) availability of borrowings and letters of credit under the Company s credit facilities; (xvii) the ability of the Company s subsidiaries to pay dividends to the holding company, XL Capital Ltd; (xviii) the potential effect of domestic and foreign regulatory developments, including those which could increase the Company s business costs and required capital levels; (xix) changes in regulation or tax laws applicable to the Company or its subsidiaries, brokers or customers; (xx) acceptance of the Company s products and services, including new products and services; (xxi) changes in the availability, cost or quality of reinsurance; (xxii) changes in the distribution or placement of risks due to increased consolidation of insurance and reinsurance brokers; (xxiii) loss of key personnel; (xxiv) the effects of mergers, acquisitions and divestitures; (xxv) changes in accounting policies or practices or the application thereof; (xxvi) legislative or regulatory developments including, but not limited to, changes in regulatory capital balances that must be maintained by the Company s operating subsidiaries and governmental actions for the purpose of stabilizing the financial markets; (xxvii) other changes in general economic conditions, including changes in interest rates, credit spreads, foreign currency exchange rates, inflation and other factors; (xxviii) the effects of business disruption or economic contraction due to war, terrorism or other hostilities; (xxix) changes in tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof; (xxx) XL s ability to obtain approval of the Company s ordinary shareholders and the Grand Court of the Cayman Islands for, and to satisfy the other conditions to, XL s previously announced proposed redomestication to Ireland from the Cayman Islands within the expected time frame or at all; (xxxi) XL s ability to realize the expected benefits from the redomestication; (xxxii) the occurrence of difficulties in connection with the redomestication; (xxxiii) any unanticipated costs in connection with the redomestication; and (xxxiv) the other factors set forth in the Company s other documents on file with the SEC. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. The Company undertakes no obligation to update publicly or revise any forward- looking statement, whether as a result of new information, future developments or otherwise.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following risk management discussion and the estimated amounts generated from the sensitivity and value-at-risk (VaR) analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of the Company s investment portfolio. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events of losses. See Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Market risk represents the potential for loss due to adverse changes in the fair value of financial and other instruments. The Company is principally exposed to the following market risks: interest rate risk, foreign currency exchange rate risk; equity price risk; credit risk; legacy weather and energy-related risk, and other related market risks. For a discussion of related risks, see the risk factor titled We are exposed to significant capital markets risks related to changes in interest rates, credit spreads, equity prices and

foreign exchange rates which may adversely affect our results of operations, financial condition or cash flows in Item 1A Risk Factors, above.

The Company s investment market risk arises from its investment portfolio which consists of fixed income securities, alternative investments, public equities, private investments, derivatives, other investments, and cash, denominated in both U.S. and foreign currencies, which are sensitive to changes in interest rates, credit spreads, equity prices, foreign currency exchange rates and other related market risks. The Company s fixed income and equity securities are classified as available for sale with the exception of certain Euro denominated Life assets, and as such, changes in interest rates, credit spreads on corporate and structured credit, equity prices, foreign currency exchange rates or other related market instruments will have an immediate effect on comprehensive income or loss and shareholders equity but may not have an immediate effect on net income. Changes in interest rates, credit spreads, equity prices and other related market instruments affect consolidated net income when, and if, a security is sold or impaired.

The Company conducts its derivative activities primarily in investment-related derivatives, which may include credit derivatives, and previously within weather and energy derivatives. From time to time, the Company uses investment derivative instruments such as futures, options, interest rate swaps, credit default swaps and foreign currency forward contracts to manage the duration of its investment portfolio and foreign currency exposures and also to obtain exposure to a particular financial market. The Company s derivative transactions expose the Company to interest rate risk, credit derivative risk, weather and energy risk, foreign currency exchange rate risk, equity risk, and other market risks. The Company attempts to manage these risks based on guidelines established by management and approved by the Finance Committee. Derivative instruments are carried at fair value with the resulting changes in fair value if not hedge accounted recognized in income in the period in which they occur. Credit derivatives are purchased within the Company s investment portfolio, have been sold through a limited number of contracts written as part of the Company s previous XLFS business, and were previously entered into through the Company s prior reinsurance agreements with Syncora. Following the closing of the Master Agreement, which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreement. As of December 31, 2009, the remaining credit derivative exposure outside of the Company s investment portfolio consisted of 2 contracts written by the Company that provide credit protection on senior tranches of structured finance transactions with total insured contractual payments outstanding of $271.7 million ($244.9 million principal and $26.8 million interest), weighted average contractual term to maturity of 6.0 years, a total liability recorded of $18.4 million, and an average rating of AA on the underlying obligations. As of December 31, 2009, there have been no reported events of default on the underlying obligations.

This risk management discussion and the estimated amounts generated from the sensitivity and VaR analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of the Company s investment portfolio. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events of losses. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations - Cautionary Note Regarding Forward-Looking Statements .

Interest Rate Risk

The Company s aggregate fixed income portfolio is exposed to interest rate risk. Interest rate risk is the price sensitivity of a fixed income security to changes in interest rates. A rise in interest rates generally would decrease the fair value of the Company s aggregate fixed income portfolio, offset by the Company s ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates generally would increase the fair value of the Company s aggregate fixed income portfolio, offset by lower rates of return on funds reinvested. The Company manages interest rate risk within the context of its overall asset liability management strategy by setting duration targets for its investment portfolio in line with the estimated duration of its liabilities, thus mitigating the overall economic effect of interest rate risk. The Company remains nevertheless exposed to accounting interest rate risk since

the assets are marked to market, thus subject to market conditions, while liabilities are accrued at a static rate. The hypothetical case

of an immediate 100 basis point adverse parallel shift in global bond curves as at December 31, 2009, would decrease the fair value of the Company s aggregate fixed income portfolio by approximately 4.0% or $1.4 billion on both the Company s held to maturity and available for sale portfolios. Effective October 1, 2009, in connection with the run-off of the Life investment portfolio, $546.1 million of Euro-denominated government securities with an average duration of 14.1 years were designated as held to maturity, and the mark to market impact from those securities does not impact the Company s book value.

Foreign Currency Exchange Rate Risk

Many of the Company s non-U.S. subsidiaries maintain both assets and liabilities in local currencies. Foreign currency exchange rate gains and losses arise for accounting purposes where net assets or liabilities are denominated in foreign currencies that differ from the functional currency of those subsidiaries. While unrealized foreign exchange gains and losses on underwriting balances are reported in earnings, the offsetting unrealized gains and losses on invested assets are recorded as a separate component of shareholders equity, to the extent that the asset currency does not match that entity s functional currency. This results in an accounting mismatch that will result in foreign exchange gains or loss in the consolidated statements of income depending on the movement in certain currencies. In order to improve administrative efficiencies as well as to address this accounting imbalance, the Company formed several branches with Euro and U.K. Sterling functional currencies during 2006, 2007 and 2008. Management continues to focus on attempting to limit this type of exposure in the future.

Foreign currency exchange rate risk in general is reviewed as part of the Company s risk management process. Foreign exchange contracts within the investment portfolio are utilized to manage individual portfolio foreign exchange exposures, subject to investment management service providers guidelines established by management. These contracts are not designated as specific hedges for financial reporting purposes and, therefore, realized and unrealized gains and losses on these contracts are recorded in income in the period in which they occur. These contracts generally have maturities of three months or less. The Company also attempts to manage the foreign exchange volatility arising on certain transactions denominated in foreign currencies. These include, but are not limited to, premium receivable, reinsurance contracts, claims payable and investments in subsidiaries.

The principal currencies creating foreign exchange risk for the Company are the British pound sterling, the Euro, the Swiss Franc, and the Canadian dollar. The Company s net notional foreign currency denominated exposure on foreign exchange contracts was $859.7 million and $186.2 million as at December 31, 2009 and 2008, respectively, with a net unrealized loss of $0.8 million and a net unrealized loss of $3.2 million as at December 31, 2009 and 2008, respectively.

Equity Price Risk

The Company s equity portfolio as well as certain derivatives and certain affiliate investments are exposed to equity price risk. Equity price risk is the potential loss arising from changes in the market value of equities. An immediate hypothetical 10% change in the value of each equity position in the Company s equity portfolio would affect the fair value of the equity portfolio by approximately $1.2 million as at December 31, 2009. This excludes exposures to equities in the Company s affiliate investments.

As at December 31, 2009, the Company s equity portfolio was approximately $12.0 million as compared to approximately $329.8 million as at December 31, 2008. This excludes fixed income fund investments and publicly traded alternative funds that generally do not have the risk characteristics of equity investments but do have some correlation to equity markets. As at December 31, 2009, the Company s allocation to equity securities was a negligible % of the investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased) as compared to approximately 1.1% as at December 31, 2008.

For further discussion of the exposure to equity market movements in the Company s investment portfolio see the Investment Value-at-Risk (VaR) section below.

Credit Risk

The Company s exposure in the investment portfolio to credit spreads primarily relates to market price and cash flow variability associated with changes in credit spreads. A widening of credit spreads will increase the net unrealized loss position of the investment portfolio, will increase losses associated with credit derivatives where the Company assumes credit exposure, and, if issuer credit spreads increase significantly or for an extended period of time, would likely result in higher other-than-temporary impairments. Credit spread tightening will reduce net investment income associated with new purchases of fixed maturities. In addition, market volatility can make it difficult to value certain of the Company s securities if trading becomes less frequent. As such, valuations may include assumptions or estimates that may have significant period to period changes which could have a material adverse effect on the Company s consolidated results of operations or financial condition.

The Company s exposure to market movements related to credit risk is primarily due to its investment portfolio, receivable and ceded reinsurance balances. Within the investment portfolio, credit risk is the exposure to adverse changes in the creditworthiness of individual investment holdings, issuers, groups of issuers, industries or countries. The credit spread duration representing the average percentage increase (decrease) in the Company s fixed income portfolio resulting from a 100 bp spread decline (increase) evenly across all credit markets is 3.6 years at December 31, 2009 as compared to 3.2 years at December 31, 2008. The increase in 2009 is as a result of purchases of spread products such as Agency RMBS, offset by the cumulative effects of the 2009 derisking efforts. The hypothetical case of an immediate 25 basis point increase in all the global corporate and structured credit spreads to which the Company s aggregate fixed income portfolio is exposed to at December 31, 2009 would decrease the fair value of the Company s aggregate fixed income portfolio by approximately $251.0 million. This excludes exposure to credit in the Company s alternative investments. In addition, credit risk pertains to adverse change in the creditworthiness of the Company s reinsurers and retrocessionaires, and their ability to pay certain reinsurance receivable and recoverable balances.

The Company manages credit risk in the investment portfolio, including fixed income, alternative and short-term investment through the credit research performed primarily by the investment management service providers and limitations on the investment portfolio s exposure to individual credits. Credit limits for corporate exposures are based on an internal model that allows the limits to be linked to the Company s balance sheet credit risk taking capacity while also taking into consideration internal views on specific issuers and on current or expected market credit conditions. Credit limits for other sectors are derived from the corporate limits using multipliers as a way to quantify intrinsic credit quality characteristics differences with the corporate sector. Limits are reviewed regularly and ensure that potential losses from individual defaults should not exceed predetermined levels.

In the investment portfolio, the Company reviews on a regular basis its issuer concentration, credit quality and compliance with established credit limits. Any issuer over its credit limits, experiencing financial difficulties, material credit quality deterioration or potentially subject to forthcoming credit quality deterioration is placed on a watch list for closer monitoring. Where appropriate, exposures are reduced or prevented from increasing.

The Company has also developed a proprietary model for the investment portfolio to assess corporate credit risk based upon its individual holdings mark-to-market exposure, credit rating, seniority in the capital structure, migration and default probabilities, durations, default correlations and loss severity given a default event. Based upon these factors and related market based inputs, the Company can estimate the credit risk of the Company s corporate portfolio and its various components. Assumptions are reviewed regularly to ensure the risk estimates are reasonable and reflect underlying exposures.

The table below shows the Company s aggregate fixed income portfolio by credit rating in percentage terms of the Company s aggregate fixed income exposure (including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) as at December 31, 2009.

129

	Percentage of Aggregate Fixed Income Portfolio
AAA	55.2
AA	15.6
A	18.7
BBB	7.0
BB & below	3.5
NR	0.0
Total	100.0 %

At December 31, 2009 and 2008, the average credit quality of the Company s aggregate fixed income investment portfolio was AA , excluding operating cash. The Company s $12.6 billion portfolio of government and government related, agency, sovereign and cash holdings were rated AAA at December 31, 2009. The Company s $10.5 billion portfolio of corporates is rated A . The Company s $10.8 billion structured credit portfolio is A+ rated.

The table below summarizes the Company s significant exposures (defined as having an amortized cost in excess of $50.0 million) to corporate bonds of financial issuers held within its investment portfolio, representing both amortized cost and unrealized gains (losses):

(U.S. dollars in millions)

Issuer (by Global Ultimate Parent)	Amortized Cost at December 31, 2009 (1)	Unrealized Gain (Loss) at December 31, 2009
Bank Of America Corporation	$ 266.2	$ (13.6)
Lloyds Banking Group Plc	174.3	1.5
The Goldman Sachs Group Inc.	144.6	(0.9)
Wells Fargo & Company	143.4	0.5
Banco Santander, SA	142.5	(27.5)
Citigroup Inc.	134.5	(10.7)
HSBC Holdings Plc	131.6	(4.3)
JP Morgan Chase & Co.	124.0	(7.2)
Morgan Stanley	123.8	2.6
Barclays Plc	115.1	(26.4)
AIG Inc.	86.0	(14.7)
Aviva Plc	82.6	(13.7)
Australia And New Zealand Banking Group Limited	71.8	1.2
RFS Holdings B.V.	69.5	2.4

BNP Paribas	68.9	(5.1)
Credit Suisse Group AG	68.7	(0.4)
Nationwide Building Society	67.2	(5.5)
Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A.	65.6	(2.3)
Assicurazioni Generali S.P.A.	61.0	(9.3)
Legal & General Group Plc	60.2	(12.0)
Credit Agricole SA	59.2	(7.8)
Unicredit S.P.A.	55.9	(11.0)
Danske Bank A/S	55.7	(11.1)
Northern Rock Plc	55.0	(5.0)
Societe Generale	53.3	(1.5)
Metlife, Inc.	53.2	0.6

(1) Government-guaranteed paper has been excluded from the above figures.

Within the Company s corporate financial bond holdings, the Company is further monitoring its exposures to hybrid securities, representing Tier One and Upper Tier Two securities of various financial

institutions. The following table summarizes the top ten exposures to hybrid securities, listed by amortized cost representing both amortized cost and unrealized (losses):

(U.S. dollars in millions)

Issuer (by Global Ultimate Parent)	Tier One Amortized Cost at December 31, 2009	Upper Tier Two Amortized Cost at December 31, 2009	Total Amortized Cost at December 31, 2009	Net Unrealized (Loss) at December 31, 2009
Barclays, Plc	$ 54.9	$ 60.2	$ 115.1	$ (26.4)
Banco Santander, S.A.	49.1	61.3	110.4	(26.6)
Assicurazioni Generali S.P.A	61.0		61.0	(9.3)
Aviva PLC	5.8	55.2	61.0	(11.1)
Danske Bank A/S	35.0	20.7	55.7	(11.1)
Credit Agricole SA	10.8	42.6	53.4	(7.9)
Unicredit S.P.A.	46.2		46.2	(11.2)
Bank of America Corporation.	30.3		30.3	(9.8)
Nordea Bank AB (PUBL)		29.4	29.4	(3.5)
BNP Paribas	28.8		28.8	(4.8)
Total	$ 321.9	$ 269.4	$ 591.3	$ (121.7)

As at December 31, 2009, the top 10 corporate holdings, which exclude government guaranteed and government sponsored enterprises, represented approximately 4.9% of the aggregate fixed income portfolio and approximately 16.0% of all corporate holdings. The top 10 corporate holdings listed below represent the direct bond exposure to the corporations listed below, including their subsidiaries, and excludes any securitized, credit enhanced and collateralized asset or mortgage backed securities, cash and cash equivalents, pooled notes and any over-the-counter (OTC) derivative counterparty exposures, if applicable.

Top 10 Corporate Holdings (1)	Percentage of Aggregate Fixed Income Portfolio (2)
Bank of America Corporation	0.76 %
General Electric Company Citigroup Inc	0.60 %
Lloyds Banking Group PLC	0.53 %
Pfizer Inc.	0.51 %
AT&T Inc	0.46 %
The Goldman Sachs Group, Inc	0.43 %
Wells Fargo & Company	0.43 %
Glaxosmithkline PLC.	0.42 %

Verizon Communications, Inc.	0.42 %
HSBC Holdings Plc	0.38 %

(1) Corporate issuers exclude government-backed, government-sponsored enterprises and cash and cash equivalents.

(2) Includes fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased and excludes government-guaranteed paper.

As at December 31, 2009, the top 5 corporate sector exposures listed below represented 24.4% of the aggregate fixed income investment portfolio and 78.9% of all corporate holdings.

(U.S. dollars in millions)

Top 5 Sector Exposures	**Fair Value**	**Percentage of Aggregate Fixed Income Portfolio**
Financials (1)	$ 3,950.5	11.7 %
Consumer, Non-Cyclical	1,553.5	4.6 %
Utilities	1,041.9	3.1 %
Communications	959.6	2.8 %
Industrials	756.4	2.2 %
Total	$ 8,261.9	24.4 %

(1) Government-guaranteed paper has been excluded from the above figures.

The Company also has exposure to market movement related to credit risk associated with its mortgage-backed and asset-backed securities. The table below shows the breakdown of the $10.8 billion structured credit portfolio, of which 77.9% is AAA rated:

(U.S. dollars in millions)	**Fair Value**	**Percentage of Structured Portfolio**
CMBS	$ 1,222.9	11.3 %
Agency RMBS	6,256.6	57.9 %
Prime RMBS	484.0	4.5 %
Core CDO (non-ABS CDOs and CLOs)	700.9	6.5 %
Other ABS:		
ABS Auto	202.2	1.9 %
ABS Credit Cards	246.4	2.3 %
ABS Other	961.6	8.9 %
Topical:		
Sub-prime first lien	377.6	3.5 %
Alt-A	316.8	2.9 %
Second lien (including sub-prime second lien mortgages)	37.8	0.3 %
ABS CDO s with sub-prime collateral	5.4	0.0 %
Total	$ 10,812.2	100.0 %

For further discussion of the exposure to credit market movements in the Company s investment portfolio see the Investment Value-at-Risk section below.

Credit derivatives are purchased within the Company s investment portfolio, have been sold through a limited number of contracts written as part of the Company s previous XL Financial Solutions business, and were previously entered into through the Company s prior reinsurance agreements with Syncora, as described below. From time to time, the Company may purchase credit default swaps to hedge an existing position or concentration of holdings. The credit derivatives are recorded at fair value. Following the secondary sale of Syncora common shares, the Company retained some credit derivative exposures written by Syncora and certain of its subsidiaries through reinsurance agreements that had certain derivatives exposures embedded within them. Following the closing of the Master Agreement which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreements. As of December 31, 2009, the remaining credit derivative exposure outside of the Company s investment portfolio consisted of 23 contracts written by the Company that provide credit protection on senior tranches of structured finance transactions with total net par values outstanding of $639.5 million, a weighted average contractual term to maturity of 5.7 years, a total liability recorded of $28.6 million, and an average rating of AA on the underlying obligations. As of December 31, 2009, there have been no reported events of default on the underlying obligations.

The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, alternatives and other investment funds and other institutions. Many of these transactions expose the Company to credit risk in the event of default of the Company s counterparty. In addition, with respect to secured transactions, the Company s credit risk may be exacerbated when the collateral held by the Company cannot be realized upon or is

liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due. The Company also has exposure to financial institutions in the form of unsecured debt instruments, derivative transactions, revolving credit facility and letter of credit commitments and equity investments. There can be no assurance that any such losses or impairments to the carrying value of these assets would not materially and adversely affect the Company s business and results of operations.

With regards to unpaid losses and loss expenses recoverable and reinsurance balances receivable, the Company has credit risk should any of its reinsurers be unable or unwilling to settle amounts due to the Company; however, these exposures are not marked to market. For further information relating to reinsurer credit risk, see Management s Discussion and Analysis of Financial Condition and Results of Operations Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable.

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

Other Market Risks

The Company s private investment portfolio is invested in limited partnerships and other entities which are not publicly traded. In addition to normal market risks, these positions may also be exposed to liquidity risk, risks related to distressed investments, and risks specific to startup or small companies. As at December 31, 2009, the Company s exposure to private investments, excluding unfunded commitments, was $324.1 million representing 1.0% of the fixed income portfolio compared to $404.8 million as at December 31, 2008.

The Company s alternative investment portfolio, which is exposed to equity and credit risk as well as certain other market risks, had a total exposure of $800.2 million making up approximately 2.4% of the investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) at December 31, 2009, as compared to December 31, 2008, where the Company had a total exposure of $1.1 billion representing approximately 3.2% of the investment portfolio. The VaR associated with the alternative investment portfolio at December 31, 2009 was approximately $60.5 million using proxy indices. For further discussion of the VaR of the Company s investment portfolio see the Investment Value-at-Risk section below.

At December 31, 2009, bond and stock index futures outstanding had a net long position of $81.8 million as compared to a net long position of $101.7 million at December 31, 2008. A 10% appreciation or depreciation of the underlying exposure to these derivative instruments would have resulted in realized gains or realized losses of $8.2 million as at December 31, 2009 and $10.2 million as at December 31, 2008, respectively. The Company may reduce its exposure to these futures through offsetting transactions, including options and forwards.

Investment Value-at-Risk (VaR)

Central to the Company s market risk management framework for Investments is VaR. VaR is a statistical risk measure, calculating the level of potential losses that could be expected to be exceeded, over a specified holding period and at a given level of confidence, in normal market conditions, due to adverse movements in the investment portfolio s underlying securities and investments valuations.

The Company uses VaR as a statistical risk measure of the two principal components of its investment portfolio:

1) Property and casualty (P&C) investment portfolio: The largest component of the investment portfolio is the P&C investment portfolio and its principal objective is to support the Company s insurance and reinsurance operations, the liabilities of which have some uncertainty as to the timing and/or amount. In addition, a smaller portion of the P&C investment portfolio supports run-off financial businesses (Structured Indemnity and Other Financial Lines), in which the liabilities have a greater level of certainty.

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

The Company calculates the VaR of the investment portfolio, the P&C investment portfolio and Life investment portfolio, using a one year holding period and a 95% level of confidence. This means that, on average, the Company could expect marked-to-market results greater than predicted by the VaR results 5% of the time, or once every 20 years. The calculation of VaR is performed monthly using an analytical, or variance-covariance approach, based on

the linear sensitivity of the investment portfolio and individual securities to a broad set of systematic market risk factors and idiosyncratic risk factors. The Company computes the parametric sensitivity of every security in the investment portfolio to changes in key interest rates, spreads, implied volatility, equities, and foreign exchange rates. The parametric exposures are summed

using the appropriate investment portfolio weights to compute the investment portfolio s exposure to these systematic and idiosyncratic market risk factors. Results for the investment portfolio are expressed both in terms of U.S. dollars and as a percentage of the Company s investment portfolio. Results for the P&C investment portfolio and Life investment portfolio are expressed both in terms of U.S. dollars and as a percentage of the Company s P&C investment portfolio and Life investment portfolio, respectively.

As part of the Company s ongoing initiatives to enhance its risk reporting activities, the Company expanded its modeling capabilities and analytics to measure the VaR of the investment portfolio, P&C investment portfolio and Life investment portfolio, excluding the foreign exchange rate risk within the portfolios. Within its asset liability framework for the investment portfolio, the Company pursues a general policy of holding the assets and liabilities in the same currency and as such the Company is not exposed to the risks associated foreign exchanges movements within the investment portfolio, as currency impacts on the assets are generally matched by corresponding impacts on the related liabilities, and accordingly are neutral to the Company s book value. The Company considers that the investment portfolio VaR, P&C investment portfolio VaR and Life investment portfolio VaR, results excluding foreign exchange rate risk are the more relevant and appropriate metrics to consider when assessing the actual risk of the portfolios.

The modeling of the risk of any portfolio, as measured by VaR, involves a number of assumptions and approximations. While the Company believes that its assumptions and approximations are appropriate, there is no uniform industry methodology for calculating VaR. The Company notes that different VaR results can be produced for the same portfolio dependent not only on the approach used but also on the assumptions employed when implementing the approach.

The VaR approach uses historical data to determine the sensitivity of each of the underlying securities to the risk factors incorporated into the pricing models employed in the VaR calculations. In calculating these sensitivities, greater importance is placed on the more recent data points and information. Since the VaR approach is based on historical positions and market data, VaR results should not be viewed as an absolute and predictive gauge of future financial performance or as a way for the Company to predict risk. There is no assurance that the Company s actual future losses will not exceed its VaR and the Company expects that 5% of the time the VaR will be exceeded.

Additionally, the Company acknowledges the fact that risks associated with abnormal market events can be significantly different from the VaR results and these are by definition not reflected or assessed in the VaR analysis, rather this is evaluated using the Company s stress testing framework.

The VaR of the investment portfolio at December 31, 2009 was approximately $1.8 billion including foreign exchange rate risk and $1.4 billion excluding foreign exchange rate risk. The VaR of all investment related derivatives excluding investments in affiliates and other investments was approximately $44.5 million.

In instances where the data or time series are insufficient to determine the risk factor sensitivities, the VaR approach uses proxy time series data available for similar instruments. As at December 31, 2009, approximately $5.2 billion used proxy time series data. Approximately $1.3 billion related to various fixed income portfolios (of which $337.3 million was in mortgage backed and asset backed securities), $2.4 billion to various cash portfolios, $800.2 million to alternative investments, $319.6 million to private investments, $10.5 million to equity portfolios, and ($6.6 million) to derivatives. The Company reviews the proxies to ensure that an appropriate data and time series is being used in the calculations. For $485.3 million related to strategic investments, proxy time series data was not available and accordingly risk results were not modelled.

The following tables show the Company s average, minimum and maximum VaR in percentage and dollar terms for the investment portfolio, P&C investment portfolio and Life investment portfolio during the year ended December 31, 2009, based upon the VaR at quarter end dates excluding foreign exchange rate risk, and the Company s VaR in percentage and dollar terms, respectively, for the investment portfolio as at December 31, 2009. The Company s

investment portfolio VaR, P&C investment portfolio VaR and Life investment portfolio VaR as at December 31, 2009 is not necessarily indicative of future VaR levels.

	Average VaR % VaR (1)	Minimum VaR % VaR (1)	Maximum VaR % VaR (1)	At December 31, 2009 % VaR (1)
P&C investment portfolio VaR	4.20 %	3.19 %	5.12 %	3.19 %
Life investment portfolio VaR	10.61 %	9.07 %	13.64 %	9.76 %
Undiversified VaR (2)	5.33 %	4.37 %	6.52 %	4.37 %
Diversification VaR (3)	0.52 %	N/A %	N/A %	0.39 %
Investment portfolio VaR (4)(5)	4.81 %	3.98 %	5.64 %	3.98 %

(U.S. dollars in millions)	Average VaR during 2009 $VaR (6)	Minimum VaR during 2009 $VaR (6)	Maximum VaR during 2009 $VaR (6)	VaR as at December 31, 2009 $VaR (6)
P&C investment portfolio VaR (7)	$ 1,148.7	$ 931.2	$ 1,357.1	$ 931.2
Life investment portfolio VaR (7)	$ 627.6	$ 598.3	$ 688.8	$ 622.8
Investment portfolio VaR (4)(5)	$ 1,604.7	$ 1,415.0	$ 1,802.4	$ 1,415.0

(1) Based on a 95% confidence level with a one year holding period, excluding foreign exchange rate risk as described above. Results for the P&C investment portfolio and Life investment portfolio are expressed as a percentage of the P&C investment portfolio and Life investment portfolio market values,

respectively. Results for the investment portfolio, Undiversified VaR and Diversification VaR are expressed as a percentage of the investment portfolio market value.

(2) Average Undiversified VaR for the year ended December 31, 2009 and Undiversified VaR at December 31, 2009 is the market value weighted summation of the individual VaRs for the P&C investment portfolio and Life investment portfolio and, by construction, ignores any and all correlations between these portfolios (and their underlying asset classes). The Undiversified VaR therefore ignores diversification benefits that exist in between these

portfolios (and their respective underlying asset classes). Maximum and Minimum Undiversified VaR is not necessarily the summation of the individual VaRs for each of the separate portfolios since the Maximum and Minimum VaR and the Maximum and Minimum Undiversified VaR do not necessarily refer to the same point in time.

(3) Diversification VaR equals the difference between the investment portfolio VaR and the Undiversified VaR. As the former explicitly accounts for the correlations and diversification benefits that exist between the P&C investment portfolio and Life investment portfolio and the latter explicitly does not, the

difference in the two VaR results is due to the diversification benefits. These diversification benefits arise due to the risk reduction that occurs when different assets, that are not perfectly correlated, are combined in a portfolio. It will vary over time dependent on: changes in allocations; changes in the correlations between the different underlying asset classes; and changes in the underlying asset class risks. The NA reflects the fact that, since the Minimum and Maximum VaR do not refer to the same point in time, it is therefore not meaningful to calculate the Diversification VaR.

(4) Investment portfolio VaR is based on the prescribed methodology that explicitly accounts for

the diversification benefits that occur when each of the allocations to the P&C investment portfolioand Life investment portfolio (and their underlying asset classes) are included in the investment portfolio.

(5) Investment portfolio refers to the aggregate of the two main components of the Company s investment portfolio the P&C investment portfolio and Life investment portfolio.

(6) Based on a 95% confidence level with a one year holding period, expressed in millions of U.S. Dollars.

(7) P&C investment portfolio VaR and Life investment portfolio VaR are based on the prescribed

VaR methodology applied separately and independently to the P&C investment portfolio and Life investment portfolio, respectively. The VaR results take into account the risk and diversification benefits associated with the actual underlying securities, asset classes and allocations held in the P&C investment portfolio and Life investment portfolio respectively.

The Company s investment portfolio VaR is driven by: the size and duration of the overall investment portfolio; the size of the allocations to the different asset classes and securities in the asset classes; the risks associated with each of the asset classes and securities; and the correlations and diversification benefits between each of the asset classes and securities. Changes in any of these variables will have a direct impact on the Company s VaR.

Stress Testing

VaR does not provide the means to estimate the magnitude of the loss in the 5% of occurrences when the Company expects the VaR level to be exceeded. To complement the VaR analysis based on normal market environments, the Company considers the impact on the investment portfolio in several different historical stress periods to analyze the effect of unusual market conditions. The Company establishes certain historical stress test scenarios which are applied to the actual investment portfolio. As these stress tests and estimated gains and losses are based on historical events, they will not necessarily reflect future stress events or gains and losses from such events. The results of the stress test scenarios are reviewed on a regular basis to ensure they are appropriate, based on current shareholders equity, market conditions and the

Company s total risk tolerance. It is important to note that when assessing the risk of the Company s investment portfolio, the Company does not take into account either the value or risk associated with the liabilities arising from the Company s operations.

The table below shows the maximum impact on the Company s investment portfolio excluding the impact of foreign exchange rates if all events stress tested were to repeat themselves, given the actual investment portfolio s allocations at the quarters ended March 31, June 30, September 30 and December 31, 2009. The Company assumes that no action is taken during the stress period to either liquidate or rebalance the portfolio. The Company believes that this fairly reflects the potential decreased liquidity that is often associated with stressed market environments.

Stress Test	**March 31, 2009**	**June 30, 2009**	**September 30, 2009**	**December 31, 2009**
Maximum loss impact on investment portfolio	(3.6)%	(5.0)%	(5.2)%	(3.8)%
Maximum gain impact on investment portfolio	11.6 %	12.6 %	11.6 %	11.7 %

Given the investment portfolio allocations as at December 31, 2009, the Company would expect to lose approximately 3.8% of the investment portfolio if the most damaging event stress tested representing the period from September 2008 to November 2008 surrounding the Lehman bankruptcy was repeated, all other things held equal. Given the investment portfolio allocations as at December 31, 2009, the Company would expect to gain approximately 11.7% of the investment portfolio if the most favorable event stress tested, representing the bond market rally from May 2000 to June 2003 was repeated, all other things held equal.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements **Page**

Index to Consolidated Financial Statements	Page
Consolidated Balance Sheets as at December 31, 2009 and 2008	138
Consolidated Statements of Income for the years ended December 31, 2009, 2008 and 2007	139
Consolidated Statements of Comprehensive Income for the years ended December 31, 2009, 2008 and 2007	140
Consolidated Statements of Shareholders Equity for the years ended December 31, 2009, 2008 and 2007	141
Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007	142
Notes to Consolidated Financial Statements for the years ended December 31, 2009, 2008 and 2007	144

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31, 2009 AND 2008

(U.S. dollars in thousands, except share amounts)	**2009**	**2008**
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2009, $28,798,504; 2008, $28,990,477)	$ 27,512,032	$ 25,636,368
Equity securities, at fair value (cost: 2009, $12,344; 2008, $337,765)	17,779	361,819
Short-term investments, at fair value (amortized cost: 2009, $1,767,197; 2008, $1,500,767)	1,777,360	1,466,323
Total investments available for sale	29,307,171	27,464,510
Fixed maturities, held to maturity at amortized cost (fair value: 2009, $530,319; 2008, nil)	546,067	
Investments in affiliates	1,185,604	1,552,789
Other investments	783,189	459,481
Total investments	31,822,031	29,476,780
Cash and cash equivalents	3,643,697	4,353,826
Accrued investment income	350,055	363,376
Deferred acquisition costs	654,065	713,501
Ceded unearned premiums	711,875	896,216
Premiums receivable	2,597,602	3,135,985
Reinsurance balances receivable	374,844	563,694
Unpaid losses and loss expenses recoverable	3,584,028	3,997,722
Net receivable from investments sold	84,617	125,991
Goodwill and other intangible assets	845,129	853,550
Deferred tax asset, net	193,868	331,348
Other assets	717,864	836,825
Total assets	$ 45,579,675	$ 45,648,814
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 20,823,524	$ 21,650,315
Deposit liabilities	2,208,699	2,710,987
Future policy benefit reserves	5,490,119	5,452,865
Unearned premiums	3,651,310	4,217,931
Notes payable and debt	2,451,417	3,189,734
Reinsurance balances payable	378,887	726,736

Net payable for investments purchased		36,979		26,536
Other liabilities		923,650		1,056,879
Total liabilities	$	35,964,585	$	39,031,983
Commitments and Contingencies				
Redeemable Series C preference ordinary shares, 20,000,000 authorized, par value $0.01 Issued and outstanding: (2009, 7,306,920; 2008, 20,000,000)	$	182,673	$	500,000
Shareholders Equity:				
Non-controlling interest in equity of consolidated subsidiaries	$	2,305	$	1,598
Series E preference ordinary shares, 1,000,000 authorized, par value $0.01 Issued and outstanding: (2009, 1,000,000; 2008, 1,000,000)		10		10
Class A ordinary shares, 999,990,000 authorized, par value $0.01 Issued and outstanding: (2009, 342,118,986; 2008, 330,812,343)		3,421		3,308
Additional paid in capital		10,474,688		9,792,371
Accumulated other comprehensive income (loss)		(1,142,467)		(3,364,927)
Retained earnings(deficit)		94,460		(315,529)
Total shareholders equity	$	9,432,417	$	6,116,831
Total liabilities, redeemable preference ordinary shares, and shareholders equity	$	45,579,675	$	45,648,814

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

(U.S dollars in thousands, except per share amounts)	**2009**	**2008**	**2007**
Revenues:			
Net premiums earned	$ 5,706,840	$ 6,640,102	$ 7,205,356
Net investment income	1,319,823	1,768,977	2,248,807
Realized investment gains (losses):			
Net realized gains (losses) on investments sold	(108,979)	61,521	7,740
Other-than-temporary impairments on investments	(992,202)	(1,023,575)	(611,008)
Other-than-temporary impairments on investments transferred to other comprehensive income	179,744		
Total net realized (losses) on investments	(921,437)	(962,054)	(603,268)
Net realized and unrealized (losses) on derivative instruments	(33,647)	(73,368)	(55,451)
Income (loss) from investment fund affiliates	78,867	(277,696)	326,007
Fee income and other	43,201	52,158	14,271
Total revenues	$ 6,193,647	$ 7,148,119	$ 9,135,722
Expenses:			
Net losses and loss expenses incurred	$ 3,168,837	$ 3,962,898	$ 3,841,003
Claims and policy benefits	677,562	769,004	888,658
Acquisition costs	853,558	944,460	1,063,713
Operating expenses	1,055,823	1,161,934	1,144,910
Exchange (gains) losses	84,813	(184,454)	(19,734)
Interest expense	216,504	351,800	621,905
Extinguishment of debt		22,527	
Impairment of goodwill		989,971	
Amortization of intangible assets	1,836	2,968	1,680
Total expenses	$ 6,058,933	$ 8,021,108	$ 7,542,135
Income (loss) before income tax and income (loss) from operating affiliates	$ 134,714	$ (872,989)	$ 1,593,587
Provision for income tax	120,307	222,578	233,922
Income (loss) from operating affiliates	60,480	(1,458,246)	(1,059,848)

Net income (loss)	$ 74,887	$ (2,553,813)	$ 299,817
Non-controlling interest in net (gain) loss of subsidiary	(104)		23,928
Net income (loss) attributable to XL Capital Ltd	$ 74,991	$ (2,553,813)	$ 275,889
Preference share dividends	(80,200)	(78,645)	(69,514)
Gain on redemption of Series C Preference Ordinary Shares	211,816		
Net income (loss) attributable to ordinary shareholders	$ 206,607	$ (2,632,458)	$ 206,375
Weighted average ordinary shares and ordinary share equivalents outstanding basic	340,612	240,657	180,353
Weighted average ordinary shares and ordinary share equivalents outstanding diluted	340,966	240,657	181,209
Earnings (loss) per ordinary share and ordinary share equivalent basic	$ 0.61	$ (10.94)	$ 1.14
Earnings (loss) per ordinary share and ordinary share equivalent diluted	$ 0.61	$ (10.94)	$ 1.14

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

(U.S dollars in thousands)	2009	2008	2007
Net income (loss) attributable to XL Capital Ltd	$ 74,991	$ (2,553,813)	$ 275,889
Impact of adoption of new authoritative OTTI guidance, net of taxes	(229,670)		
Change in net unrealized gains (losses) on investments, net of tax	2,391,020	(2,893,060)	(747,941)
Change in OTTI losses recognized in other comprehensive income, net of tax	(123,343)		
Change in underfunded pension liability	(3,427)	(2,124)	3,080
Change in value of cash flow hedge	438	439	4,338
Change in net unrealized gains (losses) on future policy benefit reserves	6,554	(6,998)	16,005
Foreign currency translation adjustments	180,888	(472,343)	317,319
Realization of accumulated other comprehensive loss on sale of Syncora			4,953
Comprehensive income (loss)	$ 2,297,451	$ (5,927,899)	$ (126,357)

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

(U.S. dollars in thousands)		**2009**		**2008**		**2007**
Non-controlling Interest in Equity of Consolidated Subsidiaries:						
Balance beginning of year	$	1,598	$	2,419	$	562,121
Sale of non-controlling interest						(583,622)
Non-controlling interest in net income (loss) of subsidiary		(104)				23,928
Non-controlling interest share in change in AOCI		811		(821)		(8)
Balance end of year	$	2,305	$	1,598	$	2,419
Series A, B, and E Preference Ordinary Shares:						
Balance beginning of year	$	10	$	10	$	207
Issuance of Series E preference ordinary shares						10
Redemption of Series A and B preference ordinary shares						(207)
Balance end of year	$	10	$	10	$	10
Ordinary Shares:						
Balance beginning of year	$	3,308	$	1,779	$	1,810
Issuance of Class A ordinary shares		114		1,530		113
Exercise of stock options						9
Repurchase of Class A ordinary shares		(1)		(1)		(153)
Balance end of year	$	3,421	$	3,308	$	1,779
Additional paid in capital:						
Balance beginning of year	$	9,792,371	$	7,358,801	$	6,451,569
Issuance of Class A ordinary shares		741,177		2,387,031		874,172
Issuance of Series E preference ordinary shares						984,573
Repurchase of Class A ordinary shares		(625)		(4,965)		(515,677)
Redemption of Series A and B preference ordinary shares						(517,293)

Fair value of purchase contracts associated with equity security units				(37,860)		
Outstanding accrued contingent capital put premium				51,064		
Dividends on Series A, B and E preference ordinary shares		(42,126)				
Dividends on Class A ordinary shares		(68,389)				
Stock option exercise, expense and change in deferred compensation		52,280		38,300		81,457
Balance end of year	$	10,474,688	$	9,792,371	$	7,358,801
Accumulated Other Comprehensive Income:						
Balance beginning of year	$	(3,364,927)	$	9,159	$	411,405
Impact of adoption of new authoritative OTTI guidance, net of taxes		(229,670)				
Change in net unrealized gains (losses) on investment portfolio, net of tax		2,376,556		(2,846,989)		(775,159)
Change in net unrealized gains (losses) on affiliate and other investments, net of tax		14,464		(46,071)		27,218
Change in OTTI losses recognized in other comprehensive income, net of tax		(123,343)				
Change in underfunded pension liability		(3,427)		(2,124)		3,080
Change in value of cash flow hedge		438		439		4,338
Change in net unrealized gain (loss) on future policy benefit reserves		6,554		(6,998)		16,005
Foreign currency translation adjustments		180,888		(472,343)		317,319
Realization of accumulated other comprehensive loss on sale of Syncora						4,953
Balance end of year	$	(1,142,467)	$	(3,364,927)	$	9,159
Retained (Deficit) Earnings:						
Balance beginning of year	$	(315,529)	$	2,578,393	$	3,266,175
Impact of adoption of new authoritative OTTI guidance, net of tax		229,670				
Net income (loss) attributable to XL Capital Ltd		74,991		(2,553,813)		275,889
Dividends on Class A ordinary shares		(68,415)		(261,464)		(274,037)
Dividends on Series A, B and E preference ordinary shares		(38,073)		(78,645)		(69,514)
Repurchase of shares						(620,120)
		211,816				

Gain on redemption of Series C preference ordinary shares			
Balance end of year	$ 94,460	$ (315,529)	$ 2,578,393
Total shareholders equity	$ 9,432,417	$ 6,116,831	$ 9,950,561

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

(U.S. dollars in thousands)	**2009**	**2008**	**2007**
Cash Flows Provided by (used in) Operating Activities:			
Net income (loss)	$ 74,991	$ (2,553,813)	$ 275,889
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Net realized losses on sales of investments	921,437	962,054	603,268
Net realized and unrealized losses on derivative instruments	33,647	73,368	55,451
Amortization of (discounts) on fixed maturities	(8,183)	(47,201)	(86,826)
Impairment of goodwill		989,971	
Amortization of deferred compensation	32,231	57,617	49,666
Accretion of convertible debt	999	1,003	988
Accretion of deposit liabilities	88,752	146,588	421,074
(Income) loss from investment and operating affiliates	(139,347)	1,735,942	733,841
Cash paid to Syncora		(1,775,000)	
Unpaid losses and loss expenses	(1,120,074		