

XL GROUP PLC
Form 10-Q
November 03, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from ____ to ____

Commission file number 1-10804

XL GROUP

Public Limited Company

(Exact name of registrant as specified in its charter)

Ireland
(State or other jurisdiction of
incorporation or organization)

98-0665416
(I.R.S. Employer Identification No.)

No. 1 Hatch Street Upper, 4th Floor, Dublin 2, Ireland
(Address of principal executive offices and zip code)
+353 (1) 405-2033

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Edgar Filing: XL GROUP PLC - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of November 1, 2011, there were 320,517,493 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

XL GROUP PLC

INDEX TO FORM 10-Q

		Page No.
<u>PART I FINANCIAL INFORMATION</u>		
<u>Item 1.</u>	<u>Financial Statements:</u>	
	<u>Consolidated Balance Sheets at September 30, 2011 (Unaudited) and December 31, 2010</u>	3
	<u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2011 and 2010 (Unaudited)</u>	4
	<u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2011 and 2010 (Unaudited)</u>	5
	<u>Consolidated Statements of Shareholders' Equity for the Nine Months Ended September 30, 2011 and 2010 (Unaudited)</u>	6
	<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010 (Unaudited)</u>	7
	<u>Notes to Unaudited Consolidated Financial Statements</u>	8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	46
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	83
<u>Item 4.</u>	<u>Controls and Procedures</u>	90
<u>PART II OTHER INFORMATION</u>		
<u>Item 1.</u>	<u>Legal Proceedings</u>	91
<u>Item 1A.</u>	<u>Risk Factors</u>	92
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	92
<u>Item 6.</u>	<u>Exhibits</u>	92
	<u>Signatures</u>	94

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL GROUP PLC

CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2011	December 31, 2010
<i>(U.S. dollars in thousands, except share data)</i>		
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost: 2011, \$26,750,242; 2010, \$27,322,842)	\$ 27,005,350	\$ 27,142,105
Equity securities, at fair value (cost: 2011, \$437,668; 2010, \$56,737)	409,163	84,767
Short-term investments, at fair value (amortized cost: 2011, \$367,878; 2010, \$450,491)	366,679	450,681
	<u>27,781,192</u>	<u>27,677,553</u>
Total investments available for sale	27,781,192	27,677,553
Fixed maturities, held to maturity at amortized cost (fair value: 2011, \$2,901,434; 2010, \$2,742,626)	\$ 2,725,623	\$ 2,728,335
Investments in affiliates	1,044,077	1,081,281
Other investments	1,001,575	939,470
	<u>32,552,467</u>	<u>32,426,639</u>
Total investments	32,552,467	32,426,639
Cash and cash equivalents	3,176,283	3,022,868
Accrued investment income	357,332	350,091
Deferred acquisition costs	724,349	633,035
Ceded unearned premiums	857,049	625,654
Premiums receivable	2,859,610	2,414,912
Reinsurance balances receivable	181,264	171,327
Unpaid losses and loss expenses recoverable	3,705,892	3,671,887
Receivable from investments sold	513,012	21,716
Goodwill and other intangible assets	838,725	839,508
Deferred tax asset	140,670	143,525
Other assets	718,533	702,189
	<u>\$ 46,625,186</u>	<u>\$ 45,023,351</u>
Total assets	\$ 46,625,186	\$ 45,023,351
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	\$ 20,718,988	\$ 20,531,607
Deposit liabilities	1,636,602	1,684,606
Future policy benefit reserves	4,994,579	5,075,127
Unearned premiums	4,103,846	3,484,830
Notes payable and debt	2,281,335	2,464,410
Reinsurance balances payable	539,792	122,250
Payable for investments purchased	587,756	34,315
Deferred tax liability	108,416	105,667
Other liabilities	711,886	835,590
	<u>\$ 35,683,200</u>	<u>\$ 34,338,402</u>
Total liabilities	\$ 35,683,200	\$ 34,338,402
Commitments and Contingencies	\$	\$ 71,900

Edgar Filing: XL GROUP PLC - Form 10-Q

Non-controlling interest - Redeemable Series C preference ordinary shares, 20,000,000 authorized, par value \$0.01; Issued and outstanding: (2011, nil; 2010, 2,876,000)

Shareholders' Equity:

Ordinary shares, 999,990,000 authorized, par value \$0.01; Issued and outstanding: (2011, 320,517,493; 2010, 316,396,289)

	3,206	3,165
Additional paid in capital	9,030,259	8,993,016
Accumulated other comprehensive income	456,203	100,795
Retained earnings	450,534	513,777

Shareholders' equity attributable to XL Group plc	\$ 9,940,202	\$ 9,610,753
Non-controlling interest in equity of consolidated subsidiaries	1,001,784	1,002,296

Total shareholders' equity	\$ 10,941,986	\$ 10,613,049
-----------------------------------	----------------------	----------------------

Total liabilities, redeemable preference ordinary shares and shareholders' equity	\$ 46,625,186	\$ 45,023,351
--	----------------------	----------------------

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF INCOME

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>(U.S. dollars in thousands, except per share data)</i>				
Revenues:				
Net premiums earned	\$ 1,453,326	\$ 1,365,327	\$ 4,213,048	\$ 4,036,573
Net investment income	290,106	296,730	866,874	907,648
Realized investment gains (losses):				
Net realized gains (losses) on investments sold	4,461	(30,793)	(6,899)	(30,751)
Other-than-temporary impairments on investments	(67,513)	(27,377)	(141,321)	(114,627)
Other-than-temporary impairments on investments transferred to (from) other comprehensive income	698	(10,585)	9,885	(20,939)
Total net realized gains (losses) on investments	(62,354)	(68,755)	(138,335)	(166,317)
Net realized and unrealized gains (losses) on derivative instruments	(26,916)	12,473	(34,299)	(27,903)
Income (loss) from investment fund affiliates	(7,123)	3,105	30,277	30,367
Fee income and other	10,980	11,262	30,494	29,215
Total revenues	\$ 1,658,019	\$ 1,620,142	\$ 4,968,059	\$ 4,809,583
Expenses:				
Net losses and loss expenses incurred	\$ 988,059	\$ 811,980	\$ 3,020,508	\$ 2,451,345
Claims and policy benefits	139,549	144,358	410,196	391,476
Acquisition costs	207,553	198,173	611,142	579,870
Operating expenses	246,930	236,193	773,555	710,168
Exchange (gains) losses	(39,425)	44,540	(38,409)	(8,819)
Interest expense	48,911	58,609	158,157	156,828
Loss on termination of guarantee				23,500
Amortization of intangible assets	885	465	1,394	1,394
Total expenses	\$ 1,592,462	\$ 1,494,318	\$ 4,936,543	\$ 4,305,762
Income (loss) before income tax and income (loss) from operating affiliates	\$ 65,557	\$ 125,824	\$ 31,516	\$ 503,821
Provision (benefit) for income tax	24,718	29,810	16,747	102,622
Income (loss) from operating affiliates	35,552	14,035	95,439	46,654
Net income (loss)	\$ 76,391	\$ 110,049	\$ 110,208	\$ 447,853
Non-controlling interests	(33,993)	(32,506)	(69,431)	(32,425)
Net income (loss) attributable to XL Group plc	\$ 42,398	\$ 77,543	\$ 40,777	\$ 415,428
Preference share dividends				(34,694)
Gain on redemption of Redeemable Series C preference ordinary shares				16,616
Net income (loss) attributable to ordinary shareholders	\$ 42,398	\$ 77,543	\$ 40,777	\$ 397,350
Weighted average ordinary shares and ordinary share equivalents outstanding basic	311,714	338,724	310,793	340,927
Weighted average ordinary shares and ordinary share equivalents outstanding diluted	313,848	339,819	314,842	341,764

Edgar Filing: XL GROUP PLC - Form 10-Q

Earnings per ordinary share and ordinary share equivalent	basic	\$ 0.14	\$ 0.23	\$ 0.13	\$ 1.17
Earnings per ordinary share and ordinary share equivalent	diluted	\$ 0.14	\$ 0.23	\$ 0.13	\$ 1.16

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>(U.S. dollars in thousands)</i>				
Net income (loss) attributable to XL Group plc	\$ 42,398	\$ 77,543	\$ 40,777	\$ 415,428
Impact of adoption of new authoritative embedded derivative guidance, net of tax		31,917		31,917
Change in net unrealized gains (losses) on investments, net of tax	110,124	421,905	291,330	1,285,845
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	2,954	8,721	35,620	25,113
Change in OTTI losses recognized in other comprehensive income, net of tax	3,995	49,465	28,119	81,102
Change in underfunded pension liability	1,684	(4,045)	1,287	(478)
Change in value of cash flow hedge	110	110	330	330
Change in net unrealized gain (loss) on future policy benefit reserves				(3,714)
Foreign currency translation adjustments, net	(85,635)	104,847	(1,278)	(3,461)
Comprehensive income (loss)	\$ 75,630	\$ 690,463	\$ 396,185	\$ 1,832,082

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	(Unaudited) Nine Months Ended September 30,	
<i>(U.S. dollars in thousands)</i>	2011	2010
Non-controlling Interest in Equity of Consolidated Subsidiaries:		
Balance beginning of year	\$ 1,002,296	\$ 2,305
Non-controlling interests	4	(75)
Non-controlling interest share in change in accumulated other comprehensive (income) loss	(16)	(7)
Transfer from Series E preference ordinary shares and additional paid in capital		1,000,000
Purchase of Series E preference ordinary shares	(500)	
Balance end of period	\$ 1,001,784	\$ 1,002,223
Series E Preference Ordinary Shares:		
Balance beginning of year	\$	\$ 10
Transfer to non-controlling interest in equity of consolidated subsidiaries		(10)
Balance end of period	\$	\$
Ordinary Shares:		
Balance beginning of year	\$ 3,165	\$ 3,421
Issuance of ordinary shares	307	
Exercise of stock options	1	
Buybacks of ordinary shares	(267)	(139)
Balance end of period	\$ 3,206	\$ 3,282
Additional Paid in Capital:		
Balance beginning of year	\$ 8,993,016	\$ 10,474,688
Issuance of ordinary shares	573,460	1,102
Buybacks of ordinary shares	(566,673)	(270,572)
Transfer to non-controlling interest in equity of consolidated subsidiaries		(999,990)
Exercise of stock options, net of tax	1,195	790
Share based compensation expense	29,261	26,126
Balance end of period	\$ 9,030,259	\$ 9,232,144
Accumulated Other Comprehensive Income (Loss):		
Balance beginning of year	\$ 100,795	\$ (1,142,467)
Impact of adoption of new authoritative embedded derivative guidance, net of tax		31,917
Change in net unrealized gains (losses) on investments, net of tax	291,330	1,285,845
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	35,620	25,113
Change in OTTI losses recognized in other comprehensive income, net of tax	28,119	81,102
Change in underfunded pension liability	1,287	(478)
Change in value of cash flow hedge	330	330
Foreign currency translation adjustments	(1,278)	(3,461)
Change in net unrealized gain (loss) on future policy benefit reserves		(3,714)
Balance end of period	\$ 456,203	\$ 274,187
Retained Earnings (Deficit):		

Edgar Filing: XL GROUP PLC - Form 10-Q

Balance beginning of year	\$ 513,777	\$ 94,460
Impact of adoption of new authoritative embedded derivative guidance, net of tax		(31,917)
Net income (loss) attributable to XL Group plc	40,777	415,428
Dividends on preference ordinary shares		(34,694)
Dividends on ordinary shares	(104,020)	(102,119)
Gain on redemption of Redeemable Series C preference ordinary shares		16,616
	<u> </u>	<u> </u>
Balance end of period	\$ 450,534	\$ 357,774
	<u> </u>	<u> </u>
Total Shareholders Equity	\$ 10,941,986	\$ 10,869,610
	<u> </u>	<u> </u>

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited) Nine Months Ended September 30,	
	2011	2010
<i>(U.S. dollars in thousands)</i>		
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$ 110,208	\$ 447,853
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized losses on sales of investments	138,335	166,317
Net realized and unrealized losses on derivative instruments	34,299	27,903
Amortization of premiums (discounts) on fixed maturities	83,252	39,354
(Income) loss from investment and operating affiliates	(125,716)	(77,021)
Amortization of deferred compensation	24,222	23,172
Accretion of convertible debt	750	751
Accretion of deposit liabilities	63,492	81,093
Unpaid losses and loss expenses	185,023	(70,305)
Future policy benefit reserves	(101,047)	(137,333)
Unearned premiums	615,699	203,165
Premiums receivable	(448,133)	(9,184)
Unpaid losses and loss expenses recoverable	(24,758)	(27,010)
Ceded unearned premiums	(233,148)	(88,599)
Reinsurance balances receivable	(9,422)	177,493
Deferred acquisition costs	(92,859)	(29,262)
Reinsurance balances payable	412,103	(62,689)
Deferred tax asset - net	(47,803)	52,636
Depreciation	36,544	29,099
Derivatives	(30,032)	297,280
Other assets	(21,826)	(95,489)
Other liabilities	(151,237)	(28,906)
Other	(52,429)	(91,042)
Total adjustments	\$ 255,309	\$ 381,423
Net cash provided by (used in) operating activities	\$ 365,517	\$ 829,276
Cash flows provided by (used in) investing activities:		
Proceeds from sale of fixed maturities and short-term investments	\$ 3,233,941	\$ 3,807,049
Proceeds from redemption of fixed maturities and short-term investments	2,700,412	2,114,283
Proceeds from sale of equity securities	189,818	66,893
Purchases of fixed maturities and short-term investments	(5,411,886)	(5,527,491)
Purchases of equity securities	(571,031)	(71,629)
Net dispositions of investment affiliates	166,950	230,303
Other investments, net	(39,502)	4,249
Net cash provided by (used in) investing activities	\$ 268,702	\$ 623,657
Cash flows (used in) financing activities:		
Proceeds from issuance of ordinary shares	\$ 1,196	\$ 790
Buybacks of ordinary shares	(566,940)	(270,815)
Repurchase of Redeemable Series C preference ordinary shares	(71,801)	(94,157)
Repurchase of Series E preference ordinary shares	(465)	
Dividends paid on ordinary shares	(103,331)	(101,766)
Dividends paid on preference ordinary shares		(40,267)

Edgar Filing: XL GROUP PLC - Form 10-Q

Distributions to non-controlling interests	(38,580)	
Proceeds from issuance of debt	396,400	
Deposit liabilities	(116,472)	(623,512)
	<u> </u>	<u> </u>
Net cash (used in) financing activities	\$ (499,993)	\$ (1,129,727)
Effects of exchange rate changes on foreign currency cash	19,189	(9,274)
	<u> </u>	<u> </u>
Increase (decrease) in cash and cash equivalents	153,415	313,932
Cash and cash equivalents beginning of period	3,022,868	3,643,697
	<u> </u>	<u> </u>
Cash and cash equivalents end of period	\$ 3,176,283	\$ 3,957,629
	<u> </u>	<u> </u>

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

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

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation.

For periods prior to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to, and these financial statements include the accounts of, XL Group Ltd. (formerly, XL Capital Ltd), a Cayman Islands exempted company (XL-Cayman), and its consolidated subsidiaries. For periods subsequent to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to, and these financial statements include the accounts of, XL Group plc, an Irish public limited company (XL-Ireland), and its consolidated subsidiaries.

On July 1, 2010, XL-Ireland and XL-Cayman completed a redomestication transaction in which all of the ordinary shares of XL-Cayman were exchanged for all of the ordinary shares of XL-Ireland (the Redomestication). As a result, XL-Cayman became a wholly owned subsidiary of XL-Ireland.

As described initially in the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2011, as part of the Redomestication, neither the Redeemable Series C preference ordinary shares nor the Series E preference ordinary shares were transferred from XL-Cayman to XL-Ireland. Accordingly, subsequent to July 1, 2010, these instruments represent non-controlling interests in the consolidated financial statements of the Company. The Redeemable Series C preference ordinary shares should have been reclassified as Non-controlling interest Redeemable Series C preference ordinary shares and the Series E preference ordinary shares should have been reclassified as Non-controlling interest in equity of consolidated subsidiaries. As a result, during the annual period ended December 31, 2010 and the quarterly period ended September 30, 2010, amounts related to the Redeemable Series C preference ordinary shares and the Series E preference ordinary shares were not correctly classified in the consolidated financial statements of the Company. Management believes that the misclassifications are not material to the previously issued financial statements and accordingly, the Company has revised the September 30, 2010 and the December 31, 2010 financial statements in this report. The details of these classification errors are provided below for the annual period ended December 31, 2010. None of the revised classifications affected our total shareholders' equity, net income or net income attributable to ordinary shareholders in any period. Details of the reclassifications are as follows:

Consolidated Balance Sheet at December 31, 2010*(U.S. dollars in thousands):*

	Previously Reported	Revised
Series E preference ordinary shares, 1,000,000 authorized, par value \$0.01; Issued and outstanding: (2010, 1,000,000; 2009, 1,000,000)	\$ 10	\$
Additional paid in capital	9,993,006	8,993,016
Shareholders' equity attributable to XL Group plc	10,610,753	9,610,753
Non-controlling interest in equity of consolidated subsidiaries	2,296	1,002,296

Consolidated Statement of Income and Comprehensive Income for the year ended December 31, 2010*(U.S. dollars in thousands):*

Edgar Filing: XL GROUP PLC - Form 10-Q

Non-controlling interests	\$	(4)	\$	(39,831)
Net income (loss) attributable to XL Group plc		643,377		603,550
Preference share dividends		(74,521)		(34,694)
Comprehensive income (loss)		1,886,639		1,846,812

8

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Significant Accounting Policies**(a) Recent Accounting Pronouncements**

In January 2010, the FASB issued an accounting standards update on Improving Disclosures about Fair Value Measurements. The provisions of this authoritative guidance require new disclosure about recurring and nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. This guidance was effective for the Company beginning on January 1, 2010, except for the Level 3 reconciliation disclosures, which were effective for annual periods beginning after December 15, 2010. See Note 3, Fair Value Measurements, for changes to Level 3 reconciliation disclosure. This standard affects disclosure only and, accordingly, did not have an impact on the Company's financial condition or results of operations.

In July 2010, the FASB amended the general accounting principles for receivables as they relate to the disclosures about the credit quality of financing receivables and the allowance for credit losses. This amendment requires additional disclosures that provide a greater level of disaggregated information about the credit quality of financing receivables and the allowance for credit losses. It also requires the disclosure of credit quality indicators, past due information, and modifications of financing receivables. The new disclosures are required for interim and annual periods ending after December 15, 2010, although the disclosures of reporting period activity (i.e., allowance roll-forward and modification disclosures) were required for interim and annual periods beginning after December 15, 2010. This standard affects disclosures only and, accordingly, did not have an impact on the Company's financial condition or results of operations. During the fourth quarter of 2010, the Company recorded a provision of \$9.9 million related to two structured loan investments. This provision was reduced to \$9.2 million during the third quarter of 2011. The Company holds investments in five separate structured loans with aggregate net carrying values of \$42.1 million and \$42.3 million at September 30, 2011 and December 31, 2010, respectively. In addition, the Company had gross reinsurance balances receivable and reinsurance recoverables on unpaid losses and loss expense of \$3.8 billion at each of September 30, 2011 and December 31, 2010, against which an allowance of \$108.2 million and \$121.9 million was recorded at September 30, 2011 and December 31, 2010, respectively. There were no charge offs recorded during the current period.

In October 2010, the FASB issued authoritative guidance to address disparities in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments in the updated guidance specify that incremental direct costs of contract acquisition and certain costs related directly to the acquisition activities incurred in the acquisition of new or renewal contracts should be capitalized in accordance with the amendments in the updated guidance. Costs directly related to those activities include only the portion of an employee's total compensation (excluding any compensation that is capitalized as incremental direct costs of contract acquisition) and payroll-related fringe benefits related directly to time spent performing those activities for actual acquired contracts, and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. Administrative costs, rent, depreciation, occupancy, equipment and all other general overhead costs are considered indirect costs and should be charged to expense as incurred. This guidance is effective for interim and annual periods beginning after December 15, 2011. The amendments in this guidance can be applied prospectively or retrospectively upon adoption. The Company will adopt this guidance as of January 1, 2012. The impact of adoption is not expected to be material to the Company's consolidated financial position or results of operations.

In May 2011, the FASB issued updated accounting guidance to amend existing requirements for fair value measurements and disclosures. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy, requiring quantitative information to be disclosed related to (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset's highest and best use. The guidance requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for fair value measurements of financial assets and liabilities as well as instruments classified in shareholders' equity. This guidance is effective for interim and annual periods beginning after December 15, 2011 and early application is prohibited. The Company is currently evaluating the potential impact of adopting this guidance on its consolidated financial position and results of operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Significant Accounting Policies

(a) Recent Accounting Pronouncements (Continued)

In June 2011, the FASB issued an accounting standards update on the presentation of comprehensive income in financial statements. This guidance will allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance must be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. This guidance affects disclosure only and will not have an impact on the Company's financial condition or results of operations.

In September 2011, the FASB issued an accounting standards update to simplify how entities test goodwill for impairment, by allowing an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting entity is less than its carrying amount, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test required in FASB Accounting Standards Codification Topic 350. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of a reporting unit as compared to its carrying value meets the threshold, then performing the two-step impairment step is unnecessary. In other circumstances, performance of the two-step test is required. The guidance also eliminates the option for an entity to carry forward its detailed calculation of a reporting unit's fair value in certain situations, as previously permitted. The amendments do not change the current guidance for testing other indefinite-lived intangible assets for impairment. The new guidance is effective for annual and interim goodwill tests performed for fiscal years beginning after December 15, 2011. The Company will adopt this guidance from January 1, 2012. It will not have an impact on the Company's consolidated financial condition or results of operations.

3. Fair Value Measurements

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at September 30, 2011 and December 31, 2010 by level within the fair value hierarchy (for further information, see Note 2, Significant Accounting Policies, herein and Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010):

September 30, 2011 <i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at September 30, 2011
Assets					
U.S. Government and Government-Related/Supported Corporate (1)	\$	\$ 2,108,841	\$	\$	\$ 2,108,841
Residential mortgage-backed securities Agency		10,753,121	4,787		10,757,908
Residential mortgage-backed securities Non-Agency		5,579,956	15,183		5,595,139
Commercial mortgage-backed securities		680,182	2,799		682,981
Collateralized debt obligations		1,012,492	4,394		1,016,886
Other asset-backed securities		7,733	665,842		673,575
U.S. States and political subdivisions of the States		1,059,713	17,112		1,076,825
Non-U.S. Sovereign Government, Supranational and Government-Related		1,723,554			1,723,554
		3,369,641			3,369,641
Total fixed maturities, at fair value	\$	\$ 26,295,233	\$ 710,117	\$	\$ 27,005,350
Equity securities, at fair value (2)	229,631	179,532			409,163
Short-term investments, at fair value (1)(3)		366,679			366,679
Total investments available for sale	\$ 229,631	\$ 26,841,444	\$ 710,117	\$	\$ 27,781,192
Cash equivalents (4)	1,534,055	739,057			2,273,112
Other investments (5)		562,490	114,362		676,852
Other assets (6)(7)		201,470	104	(56,079)	145,495
Total assets accounted for at fair value	\$ 1,763,686	\$ 28,344,461	\$ 824,583	\$ (56,079)	\$ 30,876,651
Liabilities					
Financial instruments sold, but not yet purchased (8)	\$	\$ 26,363	\$	\$	\$ 26,363
Other liabilities (6)(7)		19,558	52,093	(2,050)	69,601
Total liabilities accounted for at fair value	\$	\$ 45,921	\$ 52,093	\$ (2,050)	\$ 95,964

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

December 31, 2010 <i>(U.S. dollars in thousands)</i>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at December 31, 2010
Assets					
U.S. Government and Government-Related/Supported Corporate (1)	\$	\$ 2,565,444	\$	\$	\$ 2,565,444
Residential mortgage-backed securities Agency		10,932,105	36,866		10,968,971
Residential mortgage-backed securities Non-Agency		5,173,456	30,255		5,203,711
Commercial mortgage-backed securities		1,016,859	4,964		1,021,823
Collateralized debt obligations		1,170,884	1,623		1,172,507
Other asset-backed securities		12,566	721,572		734,138
U.S. States and political subdivisions of the States		935,882	24,650		960,532
Non-U.S. Sovereign Government, Supranational and Government-Related		1,360,456			1,360,456
		3,150,856	3,667		3,154,523
Total fixed maturities, at fair value	\$	\$ 26,318,508	\$ 823,597	\$	\$ 27,142,105
Equity securities, at fair value (2)	71,284	13,483			84,767
Short-term investments, at fair value (1)(3)		450,681			450,681
Total investments available for sale	\$ 71,284	\$ 26,782,672	\$ 823,597	\$	\$ 27,677,553
Cash equivalents (4)	1,358,619	540,646			1,899,265
Other investments (5)		490,320	133,717		624,037
Other assets (6)(7)		108,056	7,882	(22,995)	92,943
Total assets accounted for at fair value	\$ 1,429,903	\$ 27,921,694	\$ 965,196	\$ (22,995)	\$ 30,293,798
Liabilities					
Financial instruments sold, but not yet purchased (8)	\$ 256	\$ 21,270	\$	\$	\$ 21,526
Other liabilities (6)(7)		13,591	47,077		60,668
Total liabilities accounted for at fair value	\$ 256	\$ 34,861	\$ 47,077	\$	\$ 82,194

Notes:

(1)

Edgar Filing: XL GROUP PLC - Form 10-Q

Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, had a fair value of \$429.2 million and \$454.8 million and an amortized cost of \$460.0 million and \$504.6 million at September 30, 2011 and December 31, 2010, respectively. These notes allow the investor to participate in cash flows of the underlying bonds, including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

- (2) Included within equity securities are investments fixed income funds of \$91.1 million and nil at September 30, 2011 and December 31, 2010, respectively.
- (3) Short-term investments consist primarily of Corporate securities and U.S. Government and Government-Related/Supported securities.
- (4) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to fair value measurement guidance.
- (5) The Other investments balance excludes certain structured transactions, including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments are carried at amortized cost that totaled \$324.7 million at September 30, 2011 and \$315.4 million at December 31, 2010.
- (6) Other assets and other liabilities include derivative instruments.
- (7) The derivative balances included in each category above are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under a netting agreement. In addition, the Company held net cash collateral related to derivative positions of approximately \$54.0 million and \$23.0 million at September 30, 2011 and December 31, 2010, respectively. This balance is included within cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative positions within the balance sheet as appropriate under the netting agreement. The fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.
- (8) Financial instruments sold, but not yet purchased represent short sales and are included within Payable for investments purchased on the balance sheet.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables reflect gains and losses for the three and nine month periods ended September 30, 2011 and 2010 for all financial assets and liabilities categorized as Level 3 at September 30, 2011 and 2010, respectively. The tables do not include gains or losses that were reported in Level 3 in prior periods for assets that were transferred out of Level 3 prior to September 30, 2011 and 2010. Gains and losses for assets and liabilities classified within Level 3 in the table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Level 1 and 2 financial instruments entered into by the Company that are either economically hedged by certain exposures to the Level 3 positions or that hedge the exposures in Level 3 positions.

In general, Level 3 assets include securities for which values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification. Transfers into or out of Level 3 primarily arise as a result of the valuations utilized by the Company changing between either those provided by independent pricing services that do not contain significant observable inputs, or other valuations sourced from brokers which are considered Level 3.

There were no transfers between Level 1 and Level 2 during the three and nine month periods ended September 30, 2011 and 2010.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

	Level 3 Assets and Liabilities				
	Three Months Ended September 30, 2011				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 4,786	\$ 15,385	\$ 3,194	\$ 4,563	\$ 727,239
Realized gains (losses)	23	(81)	(328)	(501)	(2,662)
Movement in unrealized gains (losses)	(22)	52	76	564	(46,520)
Purchases and issuances		33			
Sales and settlements		(206)	(143)	(232)	(12,215)
Transfers into Level 3					
Transfers out of Level 3					
Fixed maturities to short-term investments classification change					
Balance, end of period	\$ 4,787	\$ 15,183	\$ 2,799	\$ 4,394	\$ 665,842
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 1	\$ (29)	\$ (252)	\$ 63	\$ (49,432)

	Level 3 Assets and Liabilities				
	Three Months Ended September 30, 2011 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government-Related	Short-term Investments	Other investments	Derivative Contracts - Net
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 17,048	\$	\$	\$ 114,540	\$ (49,645)
Realized gains (losses)	(238)			(244)	
Movement in unrealized gains (losses)	302			2,642	(2,344)
Purchases and issuances				1,667	
Sales and settlements				(4,243)	
Transfers into Level 3					
Transfers out of Level 3					
Fixed maturities to short-term investments					

Edgar Filing: XL GROUP PLC - Form 10-Q

classification change

Balance, end of period	\$ 17,112	\$	\$	\$ 114,362	\$ (51,989)
------------------------	-----------	----	----	------------	-------------

Movement in total gains
(losses) above relating to
instruments still held at the
reporting date

\$ 64	\$	\$	\$ 2,398	\$ (2,344)
-------	----	----	----------	------------

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Nine Months Ended September 30, 2011				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
Balance, beginning of period	\$ 36,866	\$ 30,255	\$ 4,964	\$ 1,623	\$ 721,572
Realized gains (losses)	(257)	(81)	(329)	(1,179)	(3,733)
Movement in unrealized gains (losses)	173	2	61	1,078	(10,104)
Purchases and issuances	6,878	33		3,155	2,379
Sales and settlements	(10,049)	(492)	(517)	(283)	(46,158)
Transfers into Level 3					1,886
Transfers out of Level 3	(28,824)	(14,534)	(1,380)		
Fixed maturities to short-term investments classification change					
Balance, end of period	\$ 4,787	\$ 15,183	\$ 2,799	\$ 4,394	\$ 665,842
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ (52)	\$ (79)	\$ (268)	\$ (855)	\$ (15,656)

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Nine Months Ended September 30, 2011 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government- Related	Short-term Investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	\$ 24,650	\$ 3,667	\$	\$ 133,717	\$ (39,195)
Realized gains (losses)	(555)			11,911	
Movement in unrealized gains (losses)	7,162			10,134	(12,620)
Purchases and issuances				9,782	
Sales and settlements	(9,114)			(51,182)	(174)
Transfers into Level 3					
Transfers out of Level 3	(5,031)	(3,667)			
Fixed maturities to short-term investments					

Edgar Filing: XL GROUP PLC - Form 10-Q

classification change

Balance, end of period	\$ 17,112	\$	\$	\$ 114,362	\$ (51,989)
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 6,287	\$	\$	\$ 19,735	\$ (12,620)

15

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

	Level 3 Assets and Liabilities				
	Three Months Ended September 30, 2010				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 40,618	\$ 1,226	\$ 10,008	\$ 427	\$ 690,906
Realized gains (losses)	(3)	(6)	(385)		(5,520)
Movement in unrealized gains (losses)	338	39	(41)	3	46,999
Purchases and issuances	2,400	6,740			
Sales and settlements	(1,282)		(6)		(11,825)
Transfers into Level 3					
Transfers out of Level 3	(30,762)		(4,518)		(28,651)
Fixed maturities to short-term investments classification change					
Balance, end of period	\$ 11,309	\$ 7,999	\$ 5,058	\$ 430	\$ 691,909
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 338	\$ 40	\$ (37)	\$ 3	\$ 46,685

	Level 3 Assets and Liabilities				
	Three Months Ended September 30, 2010 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government- Related	Short-term Investments	Other investments	Derivative Contracts - Net
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 22,521	\$ 3,182	\$	\$ 92,857	\$ 162,911
Realized gains (losses)	(7,515)			1,294	
Movement in unrealized gains (losses)	5,643	307		234	32,567
Purchases and issuances	10,714			664	
Sales and settlements				(12,489)	(1,516)
Transfers into Level 3					
Transfers out of Level 3	(1)				
Fixed maturities to short-term investments					

Edgar Filing: XL GROUP PLC - Form 10-Q

classification change

Balance, end of period	\$ 31,362	\$ 3,489	\$ 82,560	\$ 193,962
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ (2,006)	\$ 307	\$ 234	\$ 32,567

16

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

	Level 3 Assets and Liabilities Nine Months Ended September 30, 2010				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 10,311	\$ 7,894	\$ 42,190	\$ 2,755	\$ 197,149
Realized gains (losses)	(4,315)		(46)	(209)	(17,498)
Movement in unrealized gains (losses)	393	39	104	29	76,655
Purchases and issuances	1,265	7,949			
Sales and settlements	(519)		(2,294)	(707)	(16,614)
Transfers into Level 3	8,115		4,044		475,548
Transfers out of Level 3	(3,941)	(7,883)	(38,940)	(1,438)	(23,331)
Fixed maturities to short-term investments classification change					
Balance, end of period	\$ 11,309	\$ 7,999	\$ 5,058	\$ 430	\$ 691,909
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 576	\$ 39	\$ (56)	\$ (136)	\$ 72,239

	Level 3 Assets and Liabilities Nine Months Ended September 30, 2010 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government- Related	Short-term Investments	Other investments	Derivative Contracts - Net
<i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>					
Balance, beginning of period	\$ 38,179	\$ 3,217	\$	\$ 75,584	\$ 100,515
Realized gains (losses)	(19,018)			3,860	
Movement in unrealized gains (losses)	14,757	32		5,785	84,202
Purchases and issuances	12,978			11,575	10,985
Sales and settlements	(1,504)			(14,244)	(1,740)
Transfers into Level 3	204	240			
Transfers out of Level 3	(14,234)				
Fixed maturities to short-term investments					

Edgar Filing: XL GROUP PLC - Form 10-Q

classification change

Balance, end of period	\$ 31,362	\$ 3,489	\$ 82,560	\$ 193,962
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 7,642	\$ 32	\$ 5,785	\$ 84,202

17

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Fixed maturities and short-term investments

At March 31, 2010, certain collateralized debt obligations (CDOs) that were previously classified as Level 2 due to sufficient market data being available to allow a price to be determined and provided by third party pricing vendors, were transferred to Level 3 because third party vendor prices were no longer believed to be the most appropriate pricing source. Broker quotes, for which sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification, are the primary source of the valuations for these CDO securities.

Other investments

Included within the Other investments component of the Company's Level 3 valuations are private investments and alternative fund investments where the Company is not deemed to have significant influence over the investee. The fair value of these investments is based upon net asset values received from the investment manager or general partner of the respective entity. The nature of the underlying investments held by the investee which form the basis of the net asset value include assets such as private business ventures and are such that significant Level 3 inputs are utilized in the determination of the individual underlying holding values and, accordingly, the fair value of the Company's investment in each entity is classified within Level 3. The Company also incorporates factors such as the most recent financial information received, the values at which capital transactions with the investee take place, and management's judgment regarding whether any adjustments should be made to the net asset value in recording the fair value of each position. Investments in alternative funds included in Other investments utilize strategies including arbitrage, directional, event driven and multi-style. These funds potentially have lockup and gate provisions which may limit redemption liquidity. For further details regarding the nature of Other investments and related features see Item 8, Note 10, Other Investments, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Derivative instruments

Derivative instruments classified within Level 3 include: (i) certain interest rate swaps where the duration of the contract the Company holds exceeds that of the longest term on a market observable input, (ii) guaranteed minimum income benefits (GMIB) embedded within a certain reinsurance contract, (iii) a put option included within the Company's remaining contingent capital facility and (iv) credit derivatives sold providing protection on senior tranches of structured finance transactions where the value is obtained directly from the investment bank counterparty and sufficient information regarding the inputs utilized in such valuation was not obtained to support a Level 2 classification. The majority of inputs utilized in the valuations of these types of derivative contracts are considered Level 1 or Level 2; however, each valuation includes at least one Level 3 input that was significant to the valuation and, accordingly, the values are disclosed within Level 3.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

In addition, see Item 8, Note 2, Significant Accounting Policies, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for a general discussion of types of assets and liabilities that are classified within Level 3 of the fair value hierarchy as well as the Company's valuation policies for such instruments.

Financial Instruments Not Carried at Fair Value

Authoritative guidance over disclosure about fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, receivable from investments sold, other assets, payable for investments purchased, other liabilities and other financial instruments not included below approximated their fair values. The following table includes financial instruments for which the carrying value differs from the estimated fair values:

	(Unaudited)			
	September 30, 2011 Carrying Value	Fair Value	December 31, 2010 Carrying Value	Fair Value
<i>(U.S. dollars in thousands)</i>				
Fixed maturities, held to maturity	\$ 2,725,623	\$ 2,901,434	\$ 2,728,335	\$ 2,742,626
Other investments - structured transactions	\$ 324,723	\$ 316,781	\$ 327,686	\$ 317,524
Financial Assets	\$ 3,050,346	\$ 3,218,215	\$ 3,056,021	\$ 3,060,150
Deposit liabilities	\$ 1,636,602	\$ 1,760,445	\$ 1,684,606	\$ 1,737,107
Notes payable and debt	2,281,335	2,305,867	2,464,410	2,627,897
Financial Liabilities	\$ 3,917,937	\$ 4,066,312	\$ 4,149,016	\$ 4,365,004
Non-controlling interest - Redeemable Series C preference ordinary shares	\$	\$	\$ 71,900	\$ 61,115

The Company historically participated in structured transactions. Remaining structured transactions include cash loans supporting project finance transactions, providing liquidity facility financing to structured project deals and an investment in a payment obligation with an insurance company. These transactions are carried at amortized cost. The fair value of these investments held by the Company is determined through use of internal models utilizing reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Deposit liabilities include obligations under structured insurance and reinsurance transactions. For purposes of fair value disclosures, the Company determined the estimated fair value of the deposit liabilities by assuming a discount rate equal to the appropriate U.S. Treasury rate plus 220.0 basis points and the appropriate U.S. Treasury rate plus 142.3 basis points at September 30, 2011 and December 31, 2010, respectively. The discount rate incorporates the Company's own credit risk into the determination of estimated fair value.

The fair values of the Company's notes payable and debt outstanding are determined based on quoted market prices.

The fair value of the Company's Redeemable Series C preference ordinary shares outstanding is determined based on indicative quotes provided by brokers. During the three months ended September 30, 2011 all outstanding Redeemable Series C preference ordinary shares were repurchased and canceled.

Edgar Filing: XL GROUP PLC - Form 10-Q

There are no significant concentrations of credit risk within the Company's financial instruments as defined in the authoritative guidance over disclosures of fair value of financial instruments not carried at fair value, which excludes certain financial instruments, particularly insurance contracts.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information

The Company is organized into three operating segments: Insurance, Reinsurance and Life operations. The Company's general investment and financing operations are reflected in Corporate.

The Company evaluates the performance for both the Insurance and Reinsurance segments based on underwriting profit while the Life operations segment performance is based on contribution. Other items of revenue and expenditure of the Company are not evaluated at the segment level 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 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.

Three Months Ended September 30, 2011:

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

	<u>Insurance</u>	<u>Reinsurance</u>	<u>Total P&C</u>	<u>Life Operations</u>	<u>Corporate</u>	<u>Total</u>
Gross premiums written	\$ 1,156,901	\$ 619,260	\$ 1,776,161	\$ 100,564	\$	\$ 1,876,725
Net premiums written	872,757	419,949	1,292,706	90,769	\$	1,383,475
Net premiums earned	930,067	432,465	1,362,532	90,794	\$	1,453,326
Net losses and loss expenses	(767,091)	(220,968)	(988,059)	(139,549)	\$	(1,127,608)
Acquisition costs	(118,521)	(79,839)	(198,360)	(9,193)	\$	(207,553)
Operating expenses (1)	(158,134)	(40,179)	(198,313)	(2,352)	\$	(200,665)
Underwriting profit (loss)	\$ (113,679)	\$ 91,479	\$ (22,200)	\$ (60,300)	\$	\$ (82,500)
Net investment income	\$	\$	190,886	80,349	\$	271,235
Net results from structured products (2)	2,457	3,388	5,845	\$	\$	5,845
Net fee income and other (3)	(3,484)	1,120	(2,364)	41	\$	(2,323)
Net realized gains (losses) on investments	\$	\$	(39,047)	(23,307)	\$	(62,354)
Contribution from P&C, Life Operations and Corporate	\$	\$	\$ 133,120	\$ (3,217)	\$	\$ 129,903
Corporate & other:						
Net realized & unrealized gains (losses) on derivative instruments					\$ (26,916)	\$ (26,916)
Net income (loss) from investment fund affiliates and operating affiliates (4)					28,429	28,429
Exchange gains (losses)					39,425	39,425
Corporate operating expenses					(32,962)	(32,962)
Interest expense (5)					(35,885)	(35,885)
Non-controlling interests					(33,993)	(33,993)
Income taxes & other					(25,603)	(25,603)
Net income attributable to XL Group plc						\$ 42,398

Ratios P&C operations: (6)

Loss and loss expense ratio	82.5%	51.1%	72.5%
Underwriting expense ratio	29.7%	27.7%	29.1%
Combined ratio	112.2%	78.8%	101.6%

Notes:

- (1) Operating expenses exclude Corporate operating expenses, shown separately.
- (2) The net results from P&C structured products include net investment income and interest expense of \$18.9 million and \$13.1 million.
- (3) Net fee income and other includes operating expenses from the Company's loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
- (4) The Company records the income related to the alternative funds and to the private investment fund and operating affiliates on a one month and three month lag, respectively.
- (5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments and Corporate.
- (6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

Three Months Ended September 30, 2010:

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

(Unaudited)

	Insurance	Reinsurance	Total P&C	Life Operations	Corporate	Total
Gross premiums written	\$ 991,781	\$ 533,730	\$ 1,525,511	\$ 103,957	\$	\$ 1,629,468
Net premiums written	776,869	389,203	1,166,072	96,444		1,262,516
Net premiums earned	872,148	396,593	1,268,741	96,586		1,365,327
Net losses and loss expenses	(640,999)	(170,981)	(811,980)	(144,358)		(956,338)
Acquisition costs	(109,788)	(82,271)	(192,059)	(6,114)		(198,173)
Operating expenses (1)	(155,816)	(44,220)	(200,036)	(2,372)		(202,408)
Underwriting profit (loss)	\$ (34,455)	\$ 99,121	\$ 64,666	\$ (56,258)	\$	\$ 8,408
Net investment income			201,029	78,387		279,416
Net results from structured products (2)	3,015	(9,829)	(6,814)		1,566	(5,248)
Net fee income and other (3)	(3,713)	1,017	(2,696)	54		(2,642)
Net realized gains (losses) on investments			(69,770)	(1,512)	2,527	(68,755)

Contribution from P&C, Life
Operations and Corporate

\$	186,415	\$	20,671	\$	4,093	\$	211,179
----	---------	----	--------	----	-------	----	---------

Corporate & other:

Net realized & unrealized gains (losses) on derivative instruments					\$ 12,473	\$ 12,473
Net income (loss) from investment fund affiliates and operating affiliates (4)					17,140	17,140
Exchange gains (losses)					(44,540)	(44,540)
Corporate operating expenses					(19,782)	(19,782)
Interest expense (5)					(36,146)	(36,146)
Non-controlling interests					(32,506)	(32,506)
Income taxes & other					(30,275)	(30,275)

Net income attributable to XL Group
plc

77,543

Ratios P&C operations: (6)

Loss and loss expense ratio	73.5%	43.1%	64.0%
Underwriting expense ratio	30.5%	31.9%	30.9%
Combined ratio	104.0%	75.0%	94.9%

Notes:

- (1) Operating expenses exclude Corporate operating expenses, shown separately.
- (2) The net results from P&C structured products and Corporate structured products include net investment income, interest expense and operating expenses of \$15.3 million, \$22.1 million and nil and \$2.0 million, \$0.3 million and \$0.1 million, respectively.

Edgar Filing: XL GROUP PLC - Form 10-Q

- (3) Net fee income and other includes operating expenses from the Company's loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
- (4) The Company records the income related to the alternative funds and to the private investment fund and operating affiliates on a one month and three month lag, respectively.
- (5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments and Corporate.
- (6) Ratios are based on net premiums earned from P&C operations.

21

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

Nine Months Ended September
30, 2011:(U.S. dollars in thousands, except
ratios)

(Unaudited)

	Insurance	Reinsurance	Total P&C	Life Operations	Corporate	Total
Gross premiums written	\$ 3,669,280	\$ 1,968,444	\$ 5,637,724	\$ 298,504	\$	\$ 5,936,228
Net premiums written	2,684,938	1,628,109	4,313,047	272,635		4,585,682
Net premiums earned	2,713,430	1,226,923	3,940,353	272,695		4,213,048
Net losses and loss expenses	(2,163,786)	(856,722)	(3,020,508)	(410,196)		(3,430,704)
Acquisition costs	(340,048)	(244,813)	(584,861)	(26,281)		(611,142)
Operating expenses (1)	(488,837)	(129,362)	(618,199)	(7,241)		(625,440)
Underwriting profit (loss)	\$ (279,241)	\$ (3,974)	\$ (283,215)	\$ (171,023)	\$	\$ (454,238)
Net investment income			570,504	239,382		809,886
Net results from structured products (2)	8,407	9,828	18,235			18,235
Net fee income and other (3)	(12,614)	2,505	(10,109)	178		(9,931)
Net realized gains (losses) on investments			(76,181)	(62,154)		(138,335)
Contribution from P&C, Life Operations and Corporate			\$ 219,234	\$ 6,383	\$	\$ 225,617

Corporate & other:

Net realized & unrealized gains (losses) on derivative instruments					\$ (34,299)	\$ (34,299)
Net income (loss) from investment fund affiliates and operating affiliates (4)					125,716	125,716
Exchange gains (losses)					38,409	38,409
Corporate operating expenses					(107,711)	(107,711)
Interest expense (5)					(119,383)	(119,383)
Non-controlling interests					(69,431)	(69,431)
Income taxes & other					(18,141)	(18,141)

**Net income attributable to XL Group
plc****\$ 40,777****Ratios P&C operations: (6)**

Loss and loss expense ratio	79.7%	69.8%	76.7%
Underwriting expense ratio	30.6%	30.5%	30.5%
Combined ratio	110.3%	100.3%	107.2%

Notes:

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

Edgar Filing: XL GROUP PLC - Form 10-Q

- (2) The net results from P&C structured products include net investment income and interest expense of \$57.0 million and \$38.8 million.
- (3) Net fee income and other includes operating expenses from the Company's loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
- (4) The Company records the income related to the alternative funds and to the private investment fund and operating affiliates on a one month and three month lag, respectively.
- (5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments and Corporate.
- (6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

Nine Months Ended September
30, 2010:(U.S. dollars in thousands, except
ratios)

(Unaudited)

	<u>Insurance</u>	<u>Reinsurance</u>	<u>Total P&C</u>	<u>Life Operations</u>	<u>Corporate</u>	<u>Total</u>
Gross premiums written	\$ 3,209,411	\$ 1,745,493	\$ 4,954,904	\$ 309,696	\$	\$ 5,264,600
Net premiums written	2,435,557	1,441,644	3,877,201	287,204		4,164,405
Net premiums earned	2,637,825	1,110,830	3,748,655	287,918		4,036,573
Net losses and loss expenses	(1,881,502)	(569,843)	(2,451,345)	(391,476)		(2,842,821)
Acquisition costs	(312,166)	(230,448)	(542,614)	(37,256)		(579,870)
Operating expenses (1)	(472,057)	(129,910)	(601,967)	(8,145)		(610,112)
Underwriting profit (loss)	\$ (27,900)	\$ 180,629	\$ 152,729	\$ (148,959)	\$	\$ 3,770
Net investment income			610,289	234,120		844,409
Net results from structured products (2)	11,594	(1,577)	10,017		8,305	18,322
Net fee income and other (3)	(11,836)	1,911	(9,925)	208		(9,717)
Net realized gains (losses) on investments			(154,223)	(11,370)	(724)	(166,317)
Contribution from P&C, Life Operations and Corporate			<u>\$ 608,887</u>	<u>\$ 73,999</u>	<u>\$ 7,581</u>	<u>\$ 690,467</u>

Corporate & other:

Net realized & unrealized gains (losses) on derivative instruments					\$ (27,903)	\$ (27,903)
Net income (loss) from investment fund affiliates and operating affiliates (4)					77,021	77,021
Exchange gains (losses)					8,819	8,819
Corporate operating expenses					(61,438)	(61,438)
Interest expense (5)					(111,597)	(111,597)
Non-controlling interests					(32,425)	(32,425)
Loss on termination of guarantee					(23,500)	(23,500)
Income taxes & other					(104,016)	(104,016)

**Net income attributable to XL
Group plc**\$ 415,428**Ratios P&C operations: (6)**

Loss and loss expense ratio	71.3%	51.3%	65.4%
Underwriting expense ratio	29.8%	32.4%	30.5%
Combined ratio	<u>101.1%</u>	<u>83.7%</u>	<u>95.9%</u>

Notes:

- (1) Operating expenses exclude Corporate operating expenses, shown separately.
- (2) The net results from P&C structured products and Corporate structured products include net investment income, interest expense and operating expenses of \$52.2 million, \$43.6 million and \$1.3 million (credit) and \$11.0 million, \$1.7 million and \$1.0 million, respectively.
- (3) Net fee income and other includes operating expenses from the Company's loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
- (4) The Company records the income related to the alternative funds and to the private investment fund and operating affiliates on a one month and three month lag, respectively.
- (5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments and Corporate.
- (6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

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

Three Months Ended September 30, 2011:

(U.S. dollars in thousands)

(Unaudited)

	Insurance	Reinsurance	Life Operations	Total
P&C Operations:				
Casualty – professional lines	\$ 319,102	\$ 51,944	\$	\$ 371,046
Casualty – other lines	179,723	64,275		243,998
Property catastrophe		97,158		97,158
Other property	119,953	161,585		281,538
Marine, energy, aviation and satellite	138,884	32,162		171,046
Other specialty lines (1)	171,514			171,514
Other (2)	587	25,341		25,928
Structured indemnity	304			304
Total P&C Operations	\$ 930,067	\$ 432,465	\$	\$ 1,362,532
Life Operations:				
Other Life	\$	\$	\$ 57,452	\$ 57,452
Annuity			33,342	33,342
Total Life Operations	\$	\$	\$ 90,794	\$ 90,794
Total	\$ 930,067	\$ 432,465	\$ 90,794	\$ 1,453,326

Three Months ended September 30, 2010:

(U.S. dollars in thousands)

(Unaudited)

	Insurance (3)	Reinsurance (3)	Life Operations	Total
P&C Operations:				
Casualty – professional lines	\$ 326,144	\$ 58,250	\$	\$ 384,394
Casualty – other lines	147,152	55,534		202,686
Property catastrophe		77,234		77,234
Other property	102,928	153,275		256,203
Marine, energy, aviation and satellite	133,694	24,166		157,860
Other specialty lines (1)	151,742			151,742
Other (2)	2,723	27,180		29,903
Structured indemnity	7,765	954		8,719
Total P&C Operations	\$ 872,148	\$ 396,593	\$	\$ 1,268,741
Life Operations:				
Other Life	\$	\$	\$ 64,208	\$ 64,208
Annuity			32,378	32,378
Total Life Operations	\$	\$	\$ 96,586	\$ 96,586

Edgar Filing: XL GROUP PLC - Form 10-Q

Total	\$	872,148	\$	396,593	\$	96,586	\$	1,365,327
--------------	----	---------	----	---------	----	--------	----	-----------

-
- (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, whole account contracts and other lines.
 - (3) Certain reclassifications have been made to conform to current period presentation.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

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

Nine Months Ended September 30, 2011:

(U.S. dollars in thousands)

(Unaudited)

	Insurance	Reinsurance	Life Operations	Total
P&C Operations:				
Casualty – professional lines	\$ 957,399	\$ 157,577	\$	\$ 1,114,976
Casualty – other lines	518,048	184,238		702,286
Property catastrophe		286,085		286,085
Other property	343,646	433,082		776,728
Marine, energy, aviation and satellite	393,959	101,025		494,984
Other specialty lines (1)	494,966			494,966
Other (2)	3,003	68,793		71,796
Structured indemnity	2,409	(3,877)		(1,468)
Total P&C Operations	\$ 2,713,430	\$ 1,226,923	\$	\$ 3,940,353
Life Operations:				
Other Life	\$	\$	\$ 172,463	\$ 172,463
Annuity			100,232	100,232
Total Life Operations	\$	\$	\$ 272,695	\$ 272,695
Total	\$ 2,713,430	\$ 1,226,923	\$ 272,695	\$ 4,213,048

Nine months ended September 30, 2010:

(U.S. dollars in thousands)

(Unaudited)

	Insurance (3)	Reinsurance (3)	Life Operations	Total
P&C Operations:				
Casualty – professional lines	\$ 991,271	\$ 165,635	\$	\$ 1,156,906
Casualty – other lines	445,871	170,987		616,858
Property catastrophe		242,745		242,745
Other property	308,483	381,963		690,446
Marine, energy, aviation and satellite	408,184	66,807		474,991
Other specialty lines (1)	464,386			464,386
Other (2)	6,076	82,024		88,100
Structured indemnity	13,554	669		14,223
Total P&C Operations	\$ 2,637,825	\$ 1,110,830	\$	\$ 3,748,655
Life Operations:				
Other Life	\$	\$	\$ 193,540	\$ 193,540
Annuity			94,378	94,378
Total Life Operations	\$	\$	\$ 287,918	\$ 287,918

Edgar Filing: XL GROUP PLC - Form 10-Q

Total	\$ 2,637,825	\$ 1,110,830	\$ 287,918	\$ 4,036,573
--------------	--------------	--------------	------------	--------------

-
- (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, whole account contracts and other lines.
 - (3) Certain reclassifications have been made to conform to current period presentation.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments

(a) Fixed Maturities, Short-Term Investments and Equity Securities

Amortized Cost and Fair Value Summary

The cost (amortized cost for fixed maturities and short-term investments), fair value, gross unrealized gains and gross unrealized (losses), including, other-than-temporary impairments (OTTI) recorded in accumulated other comprehensive income (AOCI) of the Company's available for sale (AFS) and held to maturity (HTM) investments at September 30, 2011 and December 31, 2010 were as follows:

September 30, 2011 (U.S. dollars in thousands) (Unaudited)	Cost or Amortized Cost	Gross Unrealized Gains	Included in Accumulated Other Comprehensive Income (AOCI)		Fair Value
			Related to Changes In Estimated Fair Value	OTTI Included In Other Comprehensive Income (Loss)(1)	
			Gross Unrealized Losses		
Fixed maturities AFS					
U.S. Government and Government- Related/Supported (2)	\$ 1,972,718	\$ 141,521	\$ (5,398)	\$	\$ 2,108,841
Corporate (3) (4)	10,622,568	505,910	(306,574)	(63,996)	10,757,908
Residential mortgage-backed securities Agency	5,385,140	214,790	(4,791)		5,595,139
Residential mortgage-backed securities Non-Agency	889,949	19,689	(113,495)	(113,162)	682,981
Commercial mortgage-backed securities	978,131	50,171	(4,095)	(7,321)	1,016,886
Collateralized debt obligations	871,407	7,380	(198,340)	(6,872)	673,575
Other asset-backed securities	1,082,513	20,318	(19,393)	(6,613)	1,076,825
U.S. States and political subdivisions of the States	1,648,706	76,982	(2,134)		1,723,554
Non-U.S. Sovereign Government, Supranational and Government- Related/Supported (2)	3,299,110	105,747	(35,216)		3,369,641
Total fixed maturities AFS	\$ 26,750,242	\$ 1,142,508	\$ (689,436)	\$ (197,964)	\$ 27,005,350
Total short-term investments (2) (3)	\$ 367,878	\$ 191	\$ (1,390)	\$	\$ 366,679
Total equity securities (5)	\$ 437,668	\$ 27,324	\$ (55,829)	\$	\$ 409,163
Total investments AFS	\$ 27,555,788	\$ 1,170,023	\$ (746,655)	\$ (197,964)	\$ 27,781,192
Fixed maturities HTM					
U.S. Government and Government- Related/Supported (2)	\$ 10,494	\$ 1,300	\$	\$	\$ 11,794
Corporate	1,318,854	54,862	(18,122)		1,355,594
Residential mortgage-backed securities Non-Agency	81,923	4,898	(282)		86,539
Other asset-backed securities	284,095	14,447	(16)		298,526
Non-U.S. Sovereign Government, Supranational and Government-Related/Supported (2)	1,030,257	120,974	(2,250)		1,148,981
Total fixed maturities HTM	\$ 2,725,623	\$ 196,481	\$ (20,670)	\$	\$ 2,901,434

-
- (1) Represents the amount of OTTI losses in AOCI, which from April 1, 2009 was not included in earnings under authoritative accounting guidance.
 - (2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$2,022.7 million and fair value of \$2,058.5 million and U.S. Agencies with an amortized cost of \$531.0 million and fair value of \$581.5 million.
 - (3) Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes have a fair value of \$429.2 million and an amortized cost of \$460.0 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.
 - (4) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$485.6 million and an amortized cost of \$653.2 million at September 30, 2011.
 - (5) Included within equity securities are investments in fixed income funds with a fair value of \$91.1 million and an amortized cost of \$100.0 million at September 30, 2011.
-

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

Amortized Cost and Fair Value Summary (continued)

December 31, 2010 (U.S. dollars in thousands) (Unaudited)	Cost or Amortized Cost	Gross Unrealized Gains	Included in Accumulated Other Comprehensive Income (AOCI)		Fair Value
			Related to Changes In Estimated Fair Value	Gross Unrealized Losses OTTI Included In Other Comprehensive Income (Loss)(1)	
Fixed maturities AFS					
U.S. Government and Government- Related/Supported (2)	\$ 2,499,079	\$ 102,685	\$ (36,320)	\$	\$ 2,565,444
Corporate (3) (4)	10,962,804	361,154	(281,849)	(73,138)	10,968,971
Residential mortgage-backed securities Agency	5,059,249	153,106	(8,644)		5,203,711
Residential mortgage-backed securities Non-Agency	1,257,474	26,361	(133,761)	(128,251)	1,021,823
Commercial mortgage-backed securities	1,135,075	55,852	(7,960)	(10,460)	1,172,507
Collateralized debt obligations	920,501	11,014	(188,563)	(8,814)	734,138
Other asset-backed securities	979,539	16,111	(26,954)	(8,164)	960,532
U.S. States and political subdivisions of the States	1,379,150	16,755	(35,449)		1,360,456
Non-U.S. Sovereign Government, Supranational and Government-Related/Supported (2)	3,129,971	70,499	(45,947)		3,154,523
Total fixed maturities AFS	\$ 27,322,842	\$ 813,537	\$ (765,447)	\$ (228,827)	\$ 27,142,105
Total short-term investments (2) (3)	\$ 450,491	\$ 680	\$ (490)	\$	\$ 450,681
Total equity securities	\$ 56,737	\$ 28,083	\$ (53)	\$	\$ 84,767
Total investments AFS	\$ 27,830,070	\$ 842,300	\$ (765,990)	\$ (228,827)	\$ 27,677,553
Fixed maturities HTM					
U.S. Government and Government- Related/Supported (2)	\$ 10,541	\$ 164	\$ (9)	\$	\$ 10,696
Corporate	1,337,797	6,370	(16,325)		1,327,842
Residential mortgage-backed securities Non-Agency	82,763	634	(546)		82,851
Other asset-backed securities	287,109	1,134	(1,410)		286,833
Non-U.S. Sovereign Government, Supranational and Government-Related/Supported (2)	1,010,125	30,680	(6,401)		1,034,404
Total fixed maturities HTM	\$ 2,728,335	\$ 38,982	\$ (24,691)	\$	\$ 2,742,626

-
- (1) Represents the amount of OTTI losses in AOCI, which from April 1, 2009 was not included in earnings under authoritative accounting guidance.
 - (2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$2,101.0 million and fair value of \$2,131.2 million and U.S. Agencies with an amortized cost of \$1,019.2 million and fair value of \$1,072.6 million.
 - (3) Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes have a fair value of \$454.8 million and an amortized cost of \$504.6 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.
 - (4) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$757.8 million and an amortized cost of \$883.0 million at December 31, 2010.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

Amortized Cost and Fair Value Summary (continued)

At September 30, 2011 and December 31, 2010, approximately 2.7% and 3.5%, respectively, of the Company's fixed income investment portfolio at fair value was invested in securities which were below investment grade or not rated. Approximately 27.9% and 29.4% of the gross unrealized losses in the Company's fixed income securities portfolio at September 30, 2011 and December 31, 2010, respectively, related to securities that were below investment grade or not rated.

Classification of Fixed Income Securities

During the third quarter of 2011, the Company changed the manner in which it classifies fixed income securities between Fixed maturities and Short-term investments on the balance sheet and related note disclosures. Short-term investments under the Company's previous classification comprised investments with a remaining maturity of less than one year from the reporting date. Under this prior presentation, longer term securities were reclassified from Fixed maturities to Short-term investments as they neared maturity. Under the Company's new classification, Short-term investments include investments due to mature within one year from the date of purchase and are valued using the same external factors and in the same manner as Fixed maturities. No reclassifications will be made between Fixed maturities and Short-term investments subsequent to the initial date of purchase. The Company's new accounting classification aligns its presentation with that of its peer companies.

This change in classification did not have an impact the total value of investments available for sale on the balance sheet, nor did it impact the consolidated statements of income, comprehensive income, shareholders' equity or cash flows. The only impact, other than the changes in the balance sheet line items, are changes required within the detailed tables included within this note as well as Note 3, Fair Value Measurements, to allocate securities previously classified as Short-term investments under the former practice into the appropriate categories of Fixed maturities within each table to conform to the new accounting presentation for current and comparative periods.

During 2009 and 2010, the Company elected to hold certain fixed income securities to maturity. Consistent with this intention, the Company reclassified these securities from AFS to HTM in the consolidated financial statements. As a result of this classification, these fixed income securities are reflected in the HTM portfolio and recorded at amortized cost in the consolidated balance sheets and not fair value. The HTM portfolio is comprised of long duration non-U.S. securities, which are Euro and U.K. sterling denominated. The Company believes this HTM strategy is achievable due to the relatively stable and predictable cash flows of the Company's long-term liabilities within its Life operations segment, along with its ability to substitute other assets at a future date in the event that liquidity was required due to changes in expected cash flows or other transactions entered into related to the long-term liabilities supported by the HTM portfolio. At September 30, 2011, 98.1% of the HTM securities were rated A or higher. The unrealized appreciation at the dates of these reclassifications continues to be reported as a separate component of shareholders' equity and is being amortized over the remaining lives of the securities as an adjustment to yield in a manner consistent with the amortization of any premium or discount. At the time of the reclassifications, the unrealized U.S. dollar equivalent appreciation related to securities reclassified was \$127.4 million in total, with \$113.9 million and \$119.0 million unamortized at September 30, 2011 and December 31, 2010, respectively.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(a) Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

Contractual Maturities Summary

The contractual maturities of AFS and HTM fixed income securities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<i>(Unaudited)</i>		December 31, 2010 (1)	
	September 30, 2011 (1)			
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(U.S. dollars in thousands)</i>				
Fixed maturities - AFS				
Due less than one year	\$ 1,920,273	\$ 1,918,659	\$ 1,552,612	\$ 1,546,050
Due after 1 through 5 years	8,392,810	8,582,509	8,807,515	8,936,246
Due after 5 through 10 years	3,471,196	3,653,936	3,733,842	3,857,055
Due after 10 years	3,758,823	3,804,840	3,877,035	3,710,043
	17,543,102	17,959,944	17,971,004	18,049,394
Residential mortgage-backed securities Agency	5,385,140	5,595,139	5,059,249	5,203,711
Residential mortgage-backed securities Non-Agency	889,949	682,981	1,257,474	1,021,823
Commercial mortgage-backed securities	978,131	1,016,886	1,135,075	1,172,507
Collateralized debt obligations	871,407	673,575	920,501	734,138
Other asset-backed securities	1,082,513	1,076,825	979,539	960,532
Total mortgage and asset-backed securities	9,207,140	9,045,406	9,351,838	9,092,711
Total fixed maturities - AFS	\$ 26,750,242	\$ 27,005,350	\$ 27,322,842	\$ 27,142,105
Fixed maturities - HTM				
Due less than one year	\$ 11,263	\$ 11,237	\$	\$
Due after 1 through 5 years	124,921	125,889	125,449	125,416
Due after 5 through 10 years	393,059	400,583	348,797	346,494
Due after 10 years	1,830,362	1,978,660	1,884,217	1,901,032
	2,359,605	2,516,369	2,358,463	2,372,942
Residential mortgage-backed securities Non-Agency	81,923	86,539	82,763	82,851
Other asset-backed securities	284,095	298,526	287,109	286,833
Total mortgage and asset-backed securities	366,018	385,065	369,872	369,684
Total fixed maturities - HTM	\$ 2,725,623	\$ 2,901,434	\$ 2,728,335	\$ 2,742,626

(1) Included in the table above are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions, at their fair value of \$485.6 million and \$757.8 million at September 30, 2011 and December 31, 2010, respectively. These securities are reflected in the table based on their call date and have net

Edgar Filing: XL GROUP PLC - Form 10-Q

unrealized losses of \$167.6 million and \$143.7 million at September 30, 2011 and December 31, 2010, respectively.

OTTI Considerations

Under final authoritative accounting guidance, a debt security for which amortized cost exceeds fair value is deemed to be other-than-temporarily impaired if it meets either of the following conditions: (a) the Company intends to sell, or it is more likely than not that the Company will be required to sell, the security before a recovery in value, or (b) the Company does not expect to recover the entire amortized cost basis of the security. Other than in a situation in which the Company has the intent to sell a debt security or more likely than not will be required to sell a debt security, the amount of the OTTI related to a credit loss on the security is recognized in earnings, and the amount of the OTTI related to other factors (e.g., interest rates, market conditions, etc.) is recorded as a component of OCI. The net amount recognized in earnings (credit loss impairments) represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment (NPV). The remaining difference between the security's NPV and its fair value is recognized in OCI. Subsequent changes in the fair value of these securities are included in OCI unless a further impairment is deemed to have occurred.

In the scenario where the Company has the intent to sell a security in which its amortized cost exceeds its fair value, or it is more likely than not it will be required to sell such a security, the entire difference between the security's amortized cost and its fair value is recognized in earnings.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

Fixed Maturities, Short-Term Investments and Equity Securities (Continued)

OTTI Considerations (continued)

The determination of credit losses is based on detailed analyses of underlying cash flows. Such analyses require the use of certain assumptions to develop the estimated performance of underlying collateral. Key assumptions used include, but are not limited to, items such as RMBS default rates based on collateral duration in arrears, severity of losses on default by collateral class, collateral reinvestment rates and expected future general corporate default rates.

Factors considered in determining that a gross unrealized loss is not other-than-temporarily impaired include management's consideration of current and near term liquidity needs and other available sources of funds, an evaluation of the factors and time necessary for recovery and an assessment of whether the Company has the intention to sell or considers it more likely than not that it will be forced to sell a security.

(b) Gross Unrealized Losses

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

September 30, 2011 (U.S. dollars in thousands) (Unaudited)	Less than 12 months		Equal to or greater than 12 months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses (1)
Fixed maturities and short-term investments - AFS:				
U.S. Government and Government-Related/Supported Corporate (2) (3)	\$ 344,783	\$ (1,977)	\$ 47,632	\$ (4,203)
Residential mortgage-backed securities Agency	1,566,237	(71,007)	1,307,126	(299,904)
Residential mortgage-backed securities Non-Agency	267,693	(1,362)	32,129	(3,429)
Commercial mortgage-backed securities	112,395	(31,710)	481,732	(194,947)
Collateralized debt obligations	103,931	(4,297)	38,618	(7,119)
Other asset-backed securities	3,407	(2,330)	657,586	(202,882)
U.S. States and political subdivisions of the States	105,127	(2,075)	168,434	(23,931)
Non-U.S. Sovereign Government, Supranational and Government-Related	46,831	(288)	48,906	(1,855)
	298,381	(5,338)	369,254	(30,136)
Total fixed maturities and short-term investments - AFS	\$ 2,848,785	\$ (120,384)	\$ 3,151,417	\$ (768,406)
Total equity securities (4)	\$ 370,535	\$ (55,829)	\$	\$
Fixed maturities HTM:				
U.S. Government and Government-Related/Supported Corporate	\$ 236,991	\$ (16,006)	\$ 26,861	\$ (2,116)
Residential mortgage-backed securities Non-Agency	11,411	(282)		
Other asset-backed securities	1,118	(16)		
Non-U.S. Sovereign Government, Supranational and Government-Related/Supported	22,868	(2,250)		
Total fixed maturities HTM	\$ 272,388	\$ (18,554)	\$ 26,861	\$ (2,116)

-
- (1) On securities impacted by the April 1, 2009 changes to OTTI values, length of time of impairment is measured from the point at which securities returned to a net unrealized loss position (i.e., from April 1, 2009).
 - (2) Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, have a fair value of \$429.2 million and an amortized cost of \$460.0 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) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities, which are in a gross unrealized loss position, have a fair value of \$485.6 million and an amortized cost of \$653.2 million at September 30, 2011.
 - (4) Included within equity securities are investments in fixed income funds with a fair value of \$91.1 million and an amortized cost of \$100.0 million at September 30, 2011.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(b) Gross Unrealized Losses (Continued)

The following is an analysis of how long the AFS and HTM securities at December 31, 2010 had been in a continual unrealized loss position:

December 31, 2010 (U.S. dollars in thousands)	Less than 12 months		Equal to or greater than 12 months	
	Fair Value	Gross Unrealized Losses (1)	Fair Value	Gross Unrealized Losses (1)
Fixed maturities and short-term investments - AFS:				
U.S. Government and Government-Related/Supported Corporate (2) (3)	\$ 307,082	\$ (25,482)	\$ 117,394	\$ (10,417)
Residential mortgage-backed securities Agency	2,271,887	(80,276)	1,627,083	(275,023)
Residential mortgage-backed securities Non-Agency	280,390	(6,736)	34,186	(1,913)
Commercial mortgage-backed securities	40,052	(2,574)	843,168	(259,715)
Collateralized debt obligations	46,419	(2,472)	69,475	(15,967)
Other asset-backed securities	2,500	(51)	715,295	(197,535)
U.S. States and political subdivisions of the States	122,548	(1,619)	226,946	(33,546)
Non-U.S. Sovereign Government, Supranational and Government-Related	734,893	(30,033)	40,907	(5,452)
	459,686	(5,116)	418,322	(40,837)
Total fixed maturities and short-term investments - AFS	\$ 4,265,457	\$ (154,359)	\$ 4,092,776	\$ (840,405)
Total equity securities	\$ 158	\$ (53)	\$	\$
Fixed maturities HTM:				
U.S. Government and Government-Related/Supported Corporate	\$ 1,755	\$ (9)	\$	\$
Residential mortgage-backed securities Non-Agency	764,397	(16,325)		
Other asset-backed securities	37,899	(546)		
Non-U.S. Sovereign Government, Supranational and Government-Related/Supported	232,673	(1,410)		
	175,382	(6,401)		
Total fixed maturities HTM	\$ 1,212,106	\$ (24,691)	\$	\$

- On securities impacted by the April 1, 2009 changes to OTTI values, length of time of impairment is measured from the point at which securities returned to a net unrealized loss position (i.e., from April 1, 2009).
- Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes have a fair value of \$370.8 million and an amortized cost of \$423.9 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.
- Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$757.8 million and an amortized cost of \$883.0 million at December 31, 2010.

Edgar Filing: XL GROUP PLC - Form 10-Q

The Company had gross unrealized losses totaling \$944.7 million on 1,996 securities out of a total of 7,197 held at September 30, 2011 on its available for sale portfolio and \$20.7 million on 43 securities out of a total of 213 held on its held-to-maturity portfolio, which it considers to be temporarily impaired or includes non-credit losses on other-than-temporary impairments. Individual security positions comprising this balance have been evaluated by management to determine the severity of these impairments and whether they should be considered other-than-temporary.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(b) Gross Unrealized Losses (Continued)

Gross unrealized losses of \$944.7 million on available for sale and \$20.7 million on HTM assets at September 30, 2011 can be attributed to the following significant drivers:

gross unrealized losses of \$226.9 million related to the Non-Agency residential mortgage-backed securities (RMBS) portfolio (which consists of the Company's holdings of sub-prime Non-Agency securities, second liens, asset-backed securities (ABS) CDOs with sub-prime collateral, Alt-A mortgage exposures and Prime RMBS), which had a fair value of \$764.9 million at September 30, 2011. The Company, in conjunction with its investment manager service providers, undertook a security level review of these securities and recognized charges to the extent it believed the discounted cash flow value of any security was below its amortized cost. The Company has recognized realized losses, consisting of charges for OTTI and realized losses from sales, of approximately \$1.4 billion since the beginning of 2007 through September 30, 2011 on these asset classes.

gross unrealized losses of \$297.9 million related to the Company's Life operations investment portfolio, which had a fair value of \$6.6 billion at September 30, 2011. Of these gross unrealized losses, \$193.9 million related to \$1.3 billion of exposures to corporate financial institutions, including \$358.7 million Tier One and Upper Tier Two securities. At September 30, 2011, this portfolio had an average interest rate duration of 8.5 years, primarily denominated in U.K. sterling and Euros. As a result of the long duration, significant gross losses have arisen as the fair values of these securities are more sensitive to prevailing government interest rates and credit spreads. This portfolio is generally matched to corresponding long duration liabilities. A hypothetical parallel increase in interest rates and credit spreads of 50 and 25 basis points, respectively, would increase the unrealized losses related to this portfolio at September 30, 2011 by approximately \$270.0 million and \$102.5 million, respectively, on both the available for sale and HTM portfolios. Given the long term nature of this portfolio, the level of credit spreads on financial institutions at September 30, 2011 relative to historical averages within the U.K. and Euro-zone, and the Company's liquidity needs at September 30, 2011, the Company believes that these assets will continue to be held until such time as they mature, or credit spreads on financial institutions revert to levels more consistent with historical averages.

gross unrealized losses of \$205.1 million related to the non-life portfolio of Core CDO holdings (defined by the Company as investments in non-subprime CDOs), which consisted primarily of collateral loan obligations (CLOs) and had a fair value of \$671.9 million at September 30, 2011. The Company evaluated each of these securities in conjunction with its investment manager service providers and recognized charges to the extent it believed the discounted cash flow value of the security was below the amortized cost. The Company believes that the level of impairment is primarily a function of continually wide spreads in the CDO market, driven by the level of illiquidity in this market. The Company believes it is likely these securities will be held until either maturity or a recovery of value.

gross unrealized losses of \$163.3 million related to the corporate holdings within the Company's non-life fixed income portfolios, which had a fair value of \$8.6 billion at September 30, 2011. During the nine months ended September 30, 2011, as a result of declining credit spreads, the gross unrealized losses on these holdings has decreased. Of the gross unrealized losses noted above, \$91.5 million relate to financial institutions. In addition, \$34.9 million relate to medium term notes primarily supported by pools of investment grade European credit with varying degrees of leverage. These had a fair value of \$398.6 million at September 30, 2011. Management believes that expected cash flows from these bonds over the expected holding period will be sufficient to support the remaining reported amortized cost.

Management, in its assessment of whether securities in a gross unrealized loss position are temporarily impaired, considers the significance of the impairments. The Company had structured credit securities with gross unrealized losses of \$80.4 million, with a fair value of \$41.0 million, which at September 30, 2011 had cumulative fair value declines of greater than 50% of amortized costs. All of these are mortgage and asset-backed securities. The Company, in conjunction with its investment manager service providers, undertook a security level review of these securities and recognized charges to the extent it believed the discounted cash flow value of any security was below its amortized cost. These securities include gross unrealized losses of \$57.1 million on non-Agency RMBS, \$22.5 million on Core CDOs and \$0.7 million of commercial mortgage-backed security (CMBS) holdings.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(c) Net Realized Gains (Losses)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>(U.S. dollars in thousands)</i>				
<i>(Unaudited)</i>				
Gross realized gains	\$ 55,625	\$ 55,572	\$ 143,804	\$ 118,714
Gross realized losses on investments sold	(51,164)	(86,365)	(150,703)	(149,465)
OTTI on investments, net of amounts transferred to other comprehensive income	(66,815)	(37,962)	(131,436)	(135,566)
Net realized (losses) on investments	\$ (62,354)	\$ (68,755)	\$ (138,335)	\$ (166,317)

The Company recorded net impairment charges of \$66.8 million for the three months ended September 30, 2011. The components of the impairments include:

For structured credit securities, the Company recorded net impairments of \$32.8 million principally on non-Agency RMBS. The Company determined that the likely recovery on these securities was below the carrying value, and, accordingly, recorded an impairment on the securities to the discounted value of the cash flows of these securities.

For corporate securities, excluding medium term notes, the Company recorded net impairments totaling \$6.5 million, principally on hybrid securities.

For medium term notes backed primarily by investment grade European credit, the Company recorded net impairments of \$6.1 million. The Company adjusted the estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.

The Company recorded impairments of \$21.4 million related to foreign exchange losses arising on U.S. Dollar denominated securities held in a Swiss franc functional currency entity. These foreign exchange losses are recorded as part of the foreign currency revaluation process; however, because the Company's consolidated reporting currency is U.S. dollars, the foreign exchange impairment recorded on these securities is fully offset by a cumulative foreign currency translation adjustment gain recorded upon the consolidation of the foreign currency entity.

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

	OTTI related to Credit Losses recognized in earnings			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>(U.S. dollars in thousands)</i>				
<i>(Unaudited)</i>				
Opening balance	\$ 315,844	\$ 423,041	\$ 426,372	\$ 537,121
Credit loss impairment recognized in the current period on securities not previously impaired	10,478	5,342	26,384	24,800

Edgar Filing: XL GROUP PLC - Form 10-Q

Credit loss impairments previously recognized on securities that matured, paid down, prepaid or were sold during the period	(16,448)	(36,046)	(180,475)	(74,024)
Credit loss impairments previously recognized on securities impaired to fair value during the period				(130,891)
Additional credit loss impairments recognized in the current period on securities previously impaired	35,574	26,280	74,372	76,498
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(2,173)	(6,361)	(3,378)	(21,248)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance, September 30	\$ 343,275	\$ 412,256	\$ 343,275	\$ 412,256
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The \$16.4 million and \$180.5 million of credit loss impairment previously recognized on securities that matured, or were paid down, prepaid or sold during the three and nine months ended September 30, 2011 includes \$8.3 million and \$120.9 million, respectively, of non-Agency RMBS.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments (Continued)

(d) Affiliate Investments

During the third quarter, the Company sold its interests in an investment manager affiliate for total proceeds of \$35.0 million and a gain of \$25.3 million. In addition, this transaction includes the potential for additional amounts to be paid to the Company during 2013 and 2014 subject to the investment manager meeting certain performance targets. These amounts, if any, will be recorded when known with certainty.

6. Goodwill and Other Intangible Assets

The Company has goodwill of \$826.4 million as at September 30, 2011, of which \$428.2 million relates to the Company's Insurance segment while \$398.2 million relates to the Company's Reinsurance segment. The estimated fair values of these reporting units exceeded their net book values as of September 30, 2011 and December 31, 2010 and therefore no impairments were recorded during either period. At September 30, 2011, the ending goodwill balance is comprised of gross goodwill of \$1.82 billion offset by accumulated impairment charges of \$990 million.

The Company completed its annual goodwill impairment testing as of June 30, 2011 and 2010, which did not result in any goodwill impairments. Management have evaluated the sensitivity of the fair value calculations of our goodwill impairment test and concluded that relatively small changes to key assumptions such as discount rate, the terminal value, expected future revenues, gross margins and operating margins could result in a calculated fair value insufficient to support the current level of goodwill in certain businesses. Management have concluded that the prolonged weakened market conditions have resulted in the range of calculated fair values used for testing impairment in its reporting units being sufficiently close to the current net book values to warrant quarterly analysis until market conditions improve. Although the results of the analysis did not indicate the need for any impairment charges, if current economic conditions persist or deterioration in the overall financial markets in general occurs, it could result in goodwill impairments in the future.

For further detailed information regarding the Company's goodwill impairment testing methodology see Item 8, Note 7 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets in the Company's Annual Report on 10-K for the year ended December 31, 2010.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments

The Company enters into derivative instruments for both risk management and investment purposes. The Company is exposed to potential loss from various market risks, and manages its market risks based on guidelines established by management. The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value with the changes in fair value of derivatives shown in the consolidated statement of income as net realized and unrealized gains and losses on derivative instruments unless the derivatives are designated as hedging instruments. The accounting for derivatives that are designated as hedging instruments is described in Item 8, Note 2(h), Significant Accounting Policies - Derivative Instruments, to the Consolidated Financial Statements, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

The following table summarizes information on the location and gross amounts of derivative fair values contained in the consolidated balance sheet at September 30, 2011 and December 31, 2010:

	(Unaudited) September 30, 2011				December 31, 2010			
	Asset Derivative Notional Amount	Asset Derivative Fair Value (1)	Liability Derivative Notional Amount	Liability Derivative Fair Value (1)	Asset Derivative Notional Amount	Asset Derivative Fair Value (1)	Liability Derivative Notional Amount	Liability Derivative Fair Value (1)
<i>(U.S. dollars in thousands)</i>								
Derivatives designated as hedging instruments:								
Interest rate contracts (2)	\$ 159,056	\$ 107,707	\$	\$	\$ 161,028	\$ 74,368	\$	\$
Foreign exchange contracts	2,526,764	84,936	41,630	(1,368)	1,850,092	43,226	244,731	(12,161)
Total derivatives designated as hedging instruments	\$ 2,685,820	\$ 192,643	\$ 41,630	(1,368)	\$ 2,011,120	\$ 117,594	\$ 244,731	(12,161)
Derivatives not designated as hedging instruments:								
<i>Investment Related Derivatives:</i>								
Interest rate exposure	\$ 104,614	\$ 1,390	\$ 4,128	\$ (49)	\$ 117,689	\$ 281	\$ 41,063	\$
Foreign exchange exposure	95,626	3,023	372,456	(14,254)	82,395	1,377	272,724	(6,329)
Credit exposure	212,500	6,004	419,513	(7,847)	128,450	8,143	532,000	(5,295)
Financial market exposure	121,107	653	22,668	(2,334)	135,912	705	4,575	(27)
Commodity futures	4,456							
<i>Financial Operations</i>								
<i>Derivatives: (3)</i>								
Credit exposure (2)			174,936	(25,887)			246,292	(25,887)
<i>Other Non-Investment</i>								
<i>Derivatives:</i>								
Contingent capital facility	350,000				350,000			
Guaranteed minimum income benefit contract			83,957	(22,050)			80,025	(21,190)
Modified coinsurance funds withheld contract			69,175				72,509	
Total derivatives not designated as hedging instruments	\$ 888,303	\$ 11,070	\$ 1,146,833	\$ (72,421)	\$ 814,446	\$ 10,506	\$ 1,249,188	\$ (58,728)

(1) Derivative instruments in an asset or liability position are included within Other Assets or Other Liabilities, respectively, in the consolidated balance sheet.

Edgar Filing: XL GROUP PLC - Form 10-Q

- (2) At September 30, 2011 and December 31, 2010, the Company held net cash collateral related to these derivative positions of \$54.0 million and \$23.0 million, respectively. The collateral balance is included within cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative positions within the balance sheet as appropriate under the netting agreement.
- (3) Financial operations derivatives represent interests in variable interest entities as described in Note 11, Variable Interest Entities.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments (Continued)

(a) Derivative Instruments Designated as Fair Value Hedges

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

At September 30, 2011 and 2010, a portion of the Company's liabilities were hedged against changes in the applicable designated benchmark interest rate. Interest rate swaps are also used to hedge the changes in fair value of certain fixed rate liabilities and fixed income securities due to changes in the designated benchmark interest rate. In addition, the Company utilizes foreign exchange contracts to hedge the fair value of certain fixed income securities as well as to hedge certain net investments in foreign operations.

On October 27, 2010, the Company settled three interest rate contracts designated as fair value hedges of certain of the Company's deposit liability contracts. The derivative contracts were settled for a gain of \$149.5 million. The cumulative increase recorded to the carrying value of the deposit liability, representing the effective portion of the hedging relationship, will be amortized through interest expense over the remaining term of the deposit liability contracts. From the date of settlement through September 30, 2011, \$7.5 million of the balance was recorded as a reduction of interest expense. The remaining balance of \$142.0 million will be amortized over the weighted average period of 34.3 years remaining on these deposit contracts.

On June 7, 2010, the Company settled interest rate contracts designated as fair value hedges of certain issues of the Company's notes payable and debt. The derivative contracts were settled for a gain of \$21.6 million. The cumulative increase recorded to the carrying value of the hedged notes payable and debt, representing the effective portion of the hedging relationship, will be amortized through interest expense over the remaining term of the debt. From the date of settlement through September 30, 2011, \$9.2 million of the balance was recorded as a reduction of interest expense. The remaining balance of \$12.5 million will be amortized over the weighted average period of 2.8 years remaining to maturity of the debt.

The following table provides the total impact on earnings relating to derivative instruments formally designated as fair value hedges along with the impacts of the related hedged items for the three month periods ended September 30, 2011 and 2010:

Three Months Ended September 30, 2011

(U.S. dollars in thousands)
(Unaudited)

Derivatives Designated as Fair Value Hedges:	Gain/(Loss) Recognized in Income on Derivative	Hedged Items Amount of Gain/(Loss) Recognized in Income Attributable to Risk			Ineffective Portion of Hedging Relationship Gain/ (Loss)
		Deposit Liabilities	Fixed Maturity Investments	Notes Payable and Debt	
Interest rate exposure	\$ 20,514				
Foreign exchange exposure	18,219				
Total	\$ 38,733	\$ (21,659)	\$ (18,116)	\$	\$ (1,042)

Three Months Ended September 30, 2010

(U.S. dollars in thousands)
(Unaudited)

Hedged Items Amount of Gain/(Loss) Recognized in Income Attributable to Risk

Derivatives Designated as Fair Value Hedges:	Gain/(Loss) Recognized in Income on Derivative	Deposit Liabilities	Fixed Maturity Investments	Notes Payable and Debt	Ineffective Portion of Hedging Relationship Gain/ (Loss)
Interest rate exposure	\$ (43,698)				
Foreign exchange exposure	(33,124)				
Total	\$ (76,822)	\$ 53,417	\$ 23,646	\$	\$ 241

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments (Continued)

(a) Derivative Instruments Designated as Fair Value Hedges (Continued)

Nine Months Ended September 30,
2011(U.S. dollars in thousands)
(Unaudited)

Derivatives Designated as Fair Value Hedges:	Gain/(Loss) Recognized in Income on Derivative	Hedged Items Amount of Gain/(Loss) Recognized in Income Attributable to Risk			Ineffective Portion of Hedging Relationship Gain/ (Loss)
		Deposit Liabilities	Fixed Maturity Investments	Notes Payable and Debt	
Interest rate exposure	\$ 25,366				
Foreign exchange exposure	(3,084)				
Total	\$ 22,282	\$ (25,950)	\$ 2,890	\$	\$ (778)

Nine Months Ended September 30,
2010(U.S. dollars in thousands)
(Unaudited)

Derivatives Designated as Fair Value Hedges:	Gain/(Loss) Recognized in Income on Derivative	Hedged Items Amount of Gain/(Loss) Recognized in Income Attributable to Risk			Ineffective Portion of Hedging Relationship Gain/ (Loss)
		Deposit Liabilities	Fixed Maturity Investments	Notes Payable and Debt	
Interest rate exposure	\$ 48,339				
Foreign exchange exposure	15,432				
Total	\$ 63,771	\$ (33,326)	\$ (22,688)	\$ (15,940)	\$ (8,183)

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

The periodic coupon settlements resulted in an increase to net investment income of nil for the three and nine months ended September 30, 2011 and decreases to net investment income of \$0.3 million and \$2.3 million for the three and nine months ended September 30, 2010, respectively.

The periodic coupon settlements resulted in decreases to interest expense of \$2.6 million and \$7.7 million for the three and nine months ended September 30, 2011, respectively, and decreases to interest expense of \$10.6 million and \$45.1 million for the three and nine months ended September 30, 2010, respectively.

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

The Company utilizes foreign exchange contracts to hedge the fair value of certain net investments in foreign operations. During the three and nine months ended September 30, 2011, the Company entered into foreign exchange contracts that were formally designated as hedges of investments in foreign subsidiaries, the majority of which have functional currencies of either U.K. sterling or the Euro.

The U.S. dollar equivalent of foreign denominated net assets of \$2.0 billion and \$1.7 billion was hedged during the three and nine months ended September 30, 2011, respectively, which resulted in a derivative gain of \$75.1 million and \$5.9 million, respectively, being recorded in the cumulative translation adjustment account within AOCI for each period. There was no ineffectiveness resulting from these transactions.

The U.S. dollar equivalent of foreign denominated net assets of \$1.4 billion and \$0.8 billion was hedged during the three and nine months ended September 30, 2010, respectively, which resulted in a derivative loss of \$59.2 million and \$16.6 million, respectively, being recorded in the cumulative translation adjustment account within AOCI for each period. There was no ineffectiveness resulting from these transactions.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments (Continued)

(c) Derivatives not designated as hedging instruments

The following table provides the total impact on earnings relating to derivative instruments not formally designated as hedging instruments under authoritative accounting guidance. The impacts are all recorded through Net realized and unrealized gains (losses) on derivatives in the income statement:

(U.S. dollars in thousands)	Amount of Gain (Loss) Recognized in Income on Derivative			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>Derivatives not designated as hedging instruments:</i>				
<i>Investment Related Derivatives:</i>				
Interest rate exposure	\$ 2,559	\$ (3,500)	\$ (1,720)	\$ 1,406
Foreign exchange exposure	(23,214)	16,339	(5,763)	(11,672)
Credit exposure	5,207	(3,393)	(8,452)	(2,250)
Financial market exposure	(6,914)	58	(6,077)	193
Commodity exposure	(390)		(262)	
<i>Financial Operations Derivatives:</i>				
Credit exposure	25	25	331	(7,317)
<i>Other Non-Investment Derivatives:</i>				
Contingent capital facility	(2,075)	(2,075)	(6,158)	(6,158)
Guaranteed minimum income benefit contract	(2,038)	173	(860)	(902)
Modified coinsurance funds withheld contract	966	4,605	(4,560)	6,980
Total derivatives not designated as hedging instruments	(25,874)	12,232	(33,521)	(19,720)
Amount of gain (loss) recognized in income from ineffective portion of fair value hedges	(1,042)	241	(778)	(8,183)
Net realized and unrealized gains (losses) on derivative instruments	\$ (26,916)	\$ 12,473	\$ (34,299)	\$ (27,903)

The Company's objectives in using these derivatives are explained in sections (d) and (e) of this note.

(c)(i) Investment Related Derivatives

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

Investment Related Derivatives Interest Rate Exposure

Edgar Filing: XL GROUP PLC - Form 10-Q

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

Investment Related Derivatives Foreign Exchange Exposure

The Company uses foreign exchange contracts to manage its exposure to the effects of fluctuating foreign currencies on the value of certain of its foreign currency fixed maturities primarily within its Life operations portfolio. These contracts are not designated as specific hedges for financial reporting purposes and, therefore, realized and unrealized gains and losses on these contracts are recorded in income in the period in which they occur. These contracts generally have maturities of twelve months or less.

The Company has exposure to foreign currency exchange rate fluctuations through its operations and in its investment portfolio.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments (Continued)

(c)(i) Investment Related Derivatives (Continued)

Investment Related Derivatives Credit Exposure

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

Investment Related Derivatives Financial Market Exposure

Stock index futures may be purchased within the Company's investment portfolio in order to create synthetic equity exposure and to add value to the portfolio with overlay strategies where market inefficiencies are believed to exist. The Company previously wrote a number of resettable strike swaps contracts relating to an absolute return index and diversified baskets of funds. From time to time, the Company may enter into other financial market exposure derivative contracts on various indices including, but not limited to, inflation and commodity contracts.

(c)(ii) Financial Operations Derivatives Credit Exposure

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, Syncora Holdings Ltd, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreements.

At September 30, 2011 and December 31, 2010, the credit derivative exposures outside of the Company's investment portfolio consisted of two contracts written by the Company: one provides credit protection on the senior tranches of a structured finance transaction; the other is a European project finance loan participation. The two contracts have an aggregate outstanding exposure of \$158.7 million (\$154.4 million principal and \$4.3 million interest), and \$246.3 million (\$226.4 million principal and \$19.9 million interest), weighted average contractual term to maturity of 4.4 years and 5.3 years, a total liability recorded of \$25.9 million and \$25.9 million, and underlying obligations with an average credit rating of BB+ and B-, at September 30, 2011 and December 31, 2010, respectively.

The credit protection related to the structured finance transaction is a credit default swap that was executed in 2000. The underlying collateral is predominantly securitized pools of leveraged loans and bonds. The transaction is in compliance with most of the coverage tests except the mezzanine overcollateralization tests. As a result, both interest and principal proceeds are currently redirected to amortize the most senior notes, which reduces the Company's exposure sooner than originally anticipated. Management continues to monitor its underlying performance. The European project finance loan participation benefits from an 80% deficiency guarantee from the German state and federal governments.

At September 30, 2011, there were no reported events of default on these obligations. Credit derivatives are recorded at fair value, which is determined using models developed by the Company and is 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.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Derivative Instruments (Continued)

(c)(iii) Other Non-Investment Derivatives

The Company entered into derivatives as part of its contingent capital facility, including put options, interest rate swaps and asset return swaps. These derivatives are recorded at fair value with changes in fair value recognized in earnings.

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

(d) Contingent Credit Features

Certain derivatives agreements entered into by the Company or its subsidiaries contain rating downgrade provisions that permit early termination of the agreement by the counterparty if collateral is not posted following failure to maintain certain credit ratings from one or more of the principal credit rating agencies. If the Company were required to early terminate such agreements due to rating downgrade, it could potentially be in a net liability position at time of settlement. The aggregate fair value of all derivatives agreements containing such rating downgrade provisions that were in a net liability position on September 30, 2011 and December 31, 2010 was \$28.5 million and \$25.9 million, respectively. The Company posted collateral of \$2.1 million and nil under these agreements at September 30, 2011 and December 31, 2010, respectively.

8. Share Capital

(a) Authorized and Issued

As described in further detail in Item 8, Note 20, Share Capital, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, on November 2, 2010, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to \$1.0 billion of its ordinary shares. During 2010, the Company purchased and canceled 6.9 million ordinary shares under this program for \$144.0 million. During the first half of 2011, the Company purchased and canceled 11.6 million ordinary shares under this program for \$257.9 million. During the third quarter of 2011, the Company purchased and canceled 15.1 million ordinary shares under this program for \$307.7 million. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company's constitutional documents. All shares so redeemed were canceled upon redemption. At September 30, 2011, \$290.4 million remained available to be used for purchases under this program and no further buybacks have been made in the subsequent period to November 1, 2011.

(b) Preferred shares and Non-controlling Interest in Equity of Consolidated Subsidiaries

In August 2011, in accordance with the terms of the 10.75% equity security units (the 10.75% Units), XL-Cayman purchased and retired all of the 8.25% senior notes due August 2021 (the 8.25% Senior Notes) for \$575 million in a remarketing. These notes comprised a part of the 10.75% Units. The proceeds from the remarketing were used to satisfy the purchase price for XL-Ireland's ordinary shares issued to holders of the 10.75% Units pursuant to the forward purchase contracts comprising a part of the 10.75% Units. Each forward purchase contract provided for the issuance of 1.3242 ordinary shares of XL-Ireland at a price of \$25 per share. The settlement of the forward purchase contracts resulted in XL-Ireland's issuance of an aggregate of 30,456,600 ordinary shares for an aggregate purchase price of \$575 million. As a result of the settlement of the forward purchase contracts, the 10.75% Units ceased to exist and are no longer traded on the NYSE.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Share Capital (Continued)

(b) Preferred shares and Non-controlling Interest in Equity of Consolidated Subsidiaries (Continued)

On October 15, 2011, XL-Cayman issued \$350,000,000 of its Series D Preference Ordinary Shares (the Series D Preferred Shares) for consideration of cash and liquid investments which were held in a trust account that was part of the Stoneheath Re (Stoneheath) facility. Holders of the non-cumulative perpetual preferred securities (Stoneheath Securities) issued by Stoneheath in December 2006 will receive one Series D Preferred Share in exchange for each Stoneheath Security. This distribution will occur on November 16, 2011. Dividends on the Series D Preferred Shares will be declared and paid on a non-cumulative basis on January 15, April 15, July 15 and October 15 of each year at a floating rate of three-month LIBOR plus 3.120% on the liquidation preference, accruing from October 15, 2011. XL-Cayman intends to use the consideration it receives as partial funding for the repayment at maturity of the outstanding \$600 million par value 6.5% Guaranteed Senior Notes due January 2012 of XL Capital Finance (Europe) plc (XLCFE), with the balance available for general corporate purposes. For further details regarding Stoneheath, see Item 8, Note 17, Off-Balance Sheet Arrangements, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The Series D Preferred Shares will represent non-controlling interests in equity of consolidated subsidiaries.

On August 15, 2011, XL-Cayman completed a cash tender offer for its outstanding Redeemable Series C preference ordinary shares that resulted in 2,811,000 Redeemable Series C preference ordinary shares with a liquidation value of \$25 per share being repurchased and canceled by XL-Cayman for approximately \$71.0 million including accrued and unpaid dividends and professional fees. Subsequent to the expiration of the tender offer, and on the same terms as the offer, XL-Cayman repurchased and canceled the remaining outstanding Redeemable Series C preference ordinary shares for approximately \$0.9 million plus accrued and unpaid dividends. As of September 30, 2011, no Redeemable Series C preference ordinary shares were outstanding.

On February 16, 2011, the Company repurchased 30,000 of the outstanding Redeemable Series C preference ordinary shares with a liquidation preference value of \$0.75 million for \$0.65 million. In addition, the Company repurchased 500 of the outstanding Series E preference ordinary shares with a liquidation preference value of \$0.50 million for \$0.47 million. As a result of these repurchases, the Company recorded a reduction in Non-controlling interests of approximately \$0.13 million in the first quarter of 2011.

On February 12, 2010, the Company repurchased and canceled approximately 4.4 million Redeemable Series C preference ordinary shares with a liquidation preference value of \$110.8 million for approximately \$94.2 million, which was a portion of its outstanding Redeemable Series C preference ordinary shares. As a result, a book value gain of approximately \$16.6 million was recorded in the first quarter of 2010 to ordinary shareholders.

(c) Stock Plans

The Company's performance incentive programs provide for grants of stock options, restricted stock, restricted stock units and performance units, and stock appreciation rights. Share based compensation granted by the Company generally contains a vesting period of three or four years and certain awards also contain performance conditions. The Company records compensation expense related to each award over its vesting period incorporating the best estimate of the expected outcome of performance conditions where applicable. Compensation expense is generally recorded on a straight line basis over the vesting period of an award. See Item 8, Note 21, Share Capital, to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for further information on the Company's performance incentive programs and associated accounting.

During the nine months ended September 30, 2011, the Company granted approximately 1.0 million stock options with a weighted-average grant date fair value of \$9.82 per option. The fair value of the options issued was estimated on the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions:

Dividend yield	1.90%
Risk free interest rate	2.61%
Volatility	50.0%
Expected lives	6.0 years

Restricted stock units are granted at the closing market price of the Company's ordinary shares on the day of grant and entitle the holder to receive dividends declared and paid in the form of additional ordinary shares contingent upon vesting.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Share Capital (Continued)

(c) Stock Plans (Continued)

During the nine months ended September 30, 2011, the Company granted approximately 1.2 million restricted stock units to officers and employees of the Company with an aggregate grant date fair value of approximately \$26.6 million. Each restricted stock unit represents the Company's obligation to deliver to the holder one ordinary share upon satisfaction of the three year vesting term.

During the nine months ended September 30, 2011, the Company granted 46,062 of its restricted stock awards to its directors, with an aggregate grant date fair value of approximately \$1.1 million. Each restricted stock award represents the Company's obligation to deliver to the holder one ordinary share. A director who is granted a restricted stock award shall have all of the rights of a shareholder, including the right to vote and receive dividends. Each award vests on the date of grant, pursuant to the terms of the Directors Plan. The restricted stock awards are granted at the closing market price on the day of grant.

During the nine months ended September 30, 2011, the Company granted approximately 1.3 million performance units (representing a potential maximum share payout of approximately 2.6 million ordinary shares) to officers and employees of the Company with an aggregate grant date fair value of approximately \$28.5 million. The performance units vest after three years and entitle the holder to ordinary shares of the Company. There are no dividend rights associated with the performance units. Each grant of performance units has a target number of shares, with final payouts ranging from 0% to 200% of the grant amount depending upon a combination of corporate and business segment performance along with each employee's continued service through the vest date. Performance targets are based on relative and absolute financial performance metrics.

9. Notes Payable and Debt and Financing Arrangements

All outstanding debt of the Company at September 30, 2011 and December 31, 2010 was issued by XL-Cayman except for the \$600 million par value 6.5% Guaranteed Senior Notes due January 2012 which were issued by XLCFE. Both XL-Cayman and XLCFE are wholly-owned subsidiaries of XL-Ireland. The XLCFE notes are fully and unconditionally guaranteed by XL Company Switzerland GmbH (XL-Switzerland). The Company's ability to obtain funds from its subsidiaries to satisfy any of its obligations under this guarantee is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates, including, among others, Bermuda, the United States, Ireland, Switzerland and the U.K. Aggregated required statutory capital and surplus for the principal operating subsidiaries of the Company was \$6.2 billion at December 31, 2010.

In August 2011, in accordance with the terms of the 10.75% Units, XL-Cayman purchased and retired all of the 8.25% Senior Notes for \$575 million in a remarketing. These notes comprised a part of the 10.75% Units. The proceeds from the remarketing were used to satisfy the purchase price for XL-Ireland's ordinary shares issued to holders of the 10.75% Units pursuant to the forward purchase contracts comprising a part of the 10.75% Units. Each forward purchase contract provided for the issuance of 1.3242 ordinary shares of XL-Ireland at a price of \$25 per share. The settlement of the forward purchase contracts resulted in XL-Ireland's issuance of an aggregate of 30,456,600 ordinary shares for an aggregate purchase price of \$575 million. As a result of the settlement of the forward purchase contracts, the 10.75% Units ceased to exist and are no longer traded on the NYSE.

On September 30, 2011, XL-Cayman completed the sale of \$400 million aggregate principal amount of its 5.75% senior notes due 2021 (the 5.75% Senior Notes) at the issue price of 100% of the principal amount. The 5.75% Senior Notes are fully and unconditionally guaranteed by XL-Ireland. XL-Cayman received net proceeds of approximately \$396.4 million from the offering, which will be used to partially repay the \$600 million par value 6.5% Guaranteed Senior Notes due January 2012 which were issued by XLCFE.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Notes Payable and Debt and Financing Arrangements (Continued)

The 5.75% Senior Notes bear interest at a rate of 5.75% per annum, payable semi-annually, beginning on April 1, 2012, and mature on October 1, 2021. Upon the occurrence of a contractually defined event of default, all unpaid principal of and accrued interest and additional amounts, if any, on the 5.75% Senior Notes then outstanding will become due and payable immediately without any declaration or other act on the part of the trustee or the holders of any 5.75% Senior Notes. XL-Cayman may redeem the 5.75% Senior Notes, in whole or part, from time to time pursuant to the terms of the indenture.

Letter of Credit Facilities and Other Sources of Collateral

On March 25, 2011, the Company and certain of its subsidiaries entered into a secured credit agreement (the 2011 Credit Agreement) that currently provides for issuance of letters of credit of up to \$1 billion. Concurrent with the effectiveness of the 2011 Credit Agreement, the commitments of the lenders under the existing five-year