XL GROUP PLC
Form 10-Q
August 08, 2012

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

FORM 10-Q

xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012

OR

oTRANSITION 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	98-0665416
(State or other jurisdiction of incorporation or organization)	(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 x No o

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 x No o

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

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

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

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

XL GROUP PLC

INDEX TO FORM 10-Q

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL GROUP PLC

UNAUDITED CONSOLIDATED BALANCE SHEETS

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

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

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

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

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

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

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

See accompanying Notes to Unaudited Consolidated Financial Statements

4

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

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

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

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

2. Significant Accounting Policies

Recent Accounting Pronouncements

In October 2010, the FASB issued an accounting standards update to address disparities in practice regarding the interpretation of which costs relating to the acquisition of new and renewal insurance contracts qualify for deferral. The provisions of the guidance specify that only costs that are related directly to the successful acquisition of new and renewal insurance contracts may be capitalized. These include incremental direct costs of contract acquisition and certain other costs related directly to underwriting activities. Incremental direct costs of contract acquisition are those that result directly from and are essential to a contract transaction, and would not have been incurred by the insurance entity had the transaction not occurred. Administrative costs, rent, depreciation, occupancy, equipment and all other general overhead costs are considered indirect costs and should be charged to expense as incurred. On January 1, 2012, the Company adopted this guidance on a retrospective basis for all fiscal years presented, and interim periods within those years. The impact of adoption was a reduction in deferred acquisition costs of approximately $21 million, a reduction in deferred tax liabilities of approximately $7 million, and a corresponding reduction in opening retained earnings of approximately $14 million within the Company s December 31, 2011 balance sheet. The adoption of this guidance did not have an impact on the Company s consolidated statements of income or comprehensive income.

In May 2011, the FASB issued an accounting standards update to amend existing requirements for fair value measurements and disclosures. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy, requiring quantitative and qualitative information to be disclosed related to: (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset s highest and best use. The guidance requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value, but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for fair value measurements of financial assets and liabilities, as well as instruments classified in shareholders equity. The Company has adopted this guidance from January 1, 2012; however, it impacted disclosure only and did not have an impact on the Company s financial condition or results of operations. See Note 3, Fair Value Measurements, for these updated disclosures.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies

In June 2011, the FASB issued an accounting standards update concerning the presentation of comprehensive income in financial statements. This guidance allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income only as part of the statement of changes in shareholders equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. However, a separate accounting standards update issued in December 2011deferred indefinitely a provision within the original standard requiring entities to present components of reclassifications of other comprehensive income on the face of the income statement. The Company adopted the guidance from January 1, 2012; however, it did not have an impact on the Company s disclosure, financial condition or results of operations.

In September 2011, the FASB issued an accounting standards update to simplify how entities test goodwill for impairment, by allowing an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting entity is less than its carrying amount, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test required in FASB Accounting Standards Codification Topic 350. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of a reporting unit as compared to its carrying value meets the threshold, then performing the two-step impairment 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. The amendments do not change the current guidance for testing other indefinite-lived intangible assets for impairment. The Company adopted this guidance from January 1, 2012. It did not have an impact on the Company s consolidated financial condition or results of operations.

3. Fair Value Measurements

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

The fair values for available for sale investments are generally sourced from third parties. The fair value of fixed income securities is based upon quoted market values where available, evaluated bid prices provided by third party pricing services (pricing services) where quoted market values are not available, or by reference to broker quotes where pricing services do not provide coverage for a particular security. While the Company receives values for the majority of the investment securities it holds from pricing services, it is ultimately management s responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements.

The Company performs regular reviews of the prices received from its third party valuation sources to assess if the prices represent a reasonable estimate of the fair value. This process is completed by investment and accounting personnel who are independent of those responsible for obtaining the valuations. The approaches taken by the Company include, but are not limited to, annual reviews of the controls of the external parties responsible for sourcing valuations, which are subjected to automated tolerance checks, quarterly reviews of the valuation sources and dates, and monthly reconciliations between the valuations provided by our external parties and valuations provided by our third party investment managers at a portfolio level.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

Where broker quotes are the primary source of the valuations, sufficient information regarding the specific inputs utilized by the brokers is generally not available to support a Level 2 classification. The Company obtains the majority of broker quoted values from third party investment managers who perform independent verifications of these valuations using pricing matrices based upon information gathered by market traders. In addition, for the majority of these securities, the Company compares the broker quotes to independent valuations obtained from third party pricing vendors, which may also consist of broker quotes, to assess if the prices received represent a reasonable estimate of the fair value.

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

(a) Fair Value Summary

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

(1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, had a fair value of $186.1 million and $266.0 million and an amortized cost of $199.1 million and $297.7 million at June 30, 2012 and December 31, 2011, respectively. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(2) The Company invests in covered bonds issued by financial institutions (Covered Bonds). Covered Bonds are senior secured debt instruments issued by financial institutions and backed by over-collateralized pools of public sector or mortgage loans. At June 30, 2012, Covered Bonds within Total fixed maturities with a fair value of $500.5 million are included within Other asset-backed securities to align the Company s classification to market indices. At December 31, 2011, Covered Bonds within Total fixed maturities with a fair value of $353.9 million were reclassified from Corporate to Other asset-backed securities to conform to current period presentation.

(3) Included within Equity securities are investments in fixed income funds with a fair value of $95.8 million and $91.6 million at June 30, 2012 and December 31, 2011, respectively.

(4) Short-term investments consist primarily of Corporate securities and U.S. Government and Government-Related/Supported securities.

(5) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to fair value measurement guidance.

(6) The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments that totaled $314.0 million at June 30, 2012 and $323.7 million at December 31, 2011 are carried at amortized cost. For further details regarding the nature of Other investments and related features see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011

(7) Other assets and other liabilities include derivative instruments. The derivative balances included in each category are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under a netting agreement. In addition, the Company held net cash collateral related to derivative positions of approximately $124.7 million and $77.1 million at June 30, 2012 and December 31, 2011, respectively. This balance is included within cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative positions within the balance sheet as appropriate under the netting agreement. The fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.

(8) Financial instruments sold, but not yet purchased, represent short sales and are included within Payable for investments purchased on the balance sheet.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(b) Level 3 Gains and Losses

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables reflect gains and losses for the three and six months ended June 30, 2012 and 2011 for all financial assets and liabilities categorized as Level 3 at June 30, 2012 and 2011, respectively. The tables do not include gains or losses that were reported in Level 3 in prior periods for assets that were transferred out of Level 3 prior to June 30, 2012 and 2011. Gains and losses for assets and liabilities classified within Level 3 in the table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Level 1 and 2 financial instruments entered into by the Company that are either economically hedged by certain exposures to the Level 3 positions or that hedge the exposures in Level 3 positions.

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

There were no transfers between Level 1 and Level 2 during the three and six month periods ended June 30, 2012 and 2011.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

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

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

(U.S. dollars in thousands)	Other asset-backed securities	Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported	Short-term investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	$ 16,410	$ -	$ -	$ 115,659	$ (40,630)
Realized gains (losses)	(135)	-	-	510	-
Movement in unrealized gains (losses)	4,145	-	-	3,616	4,683
Purchases and issuances	-	-	-	2,365	-
Sales and settlements	(844)	-	-	(4,080)	-
Transfers into Level 3	5,672	-	-	-	-
Transfers out of Level 3	-	-	-	(305)	-
Fixed maturities to short-term investments classification change	-	-	-	-	-
Balance, end of period	$ 25,248	$ -	$ -	$ 117,765	$ (35,947)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 3,918	$ -	$ -	$ 1,326	$ 4,683

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

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

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

(U.S. dollars in thousands)	Other asset-backed securities	Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported	Short-term investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	$ 12,371	$ -	$ -	$ 144,834	$ (36,810)
Realized gains (losses)	161	-	-	12,155	-
Movement in unrealized gains (losses)	4,688	-	-	(1,982)	(12,725)
Purchases and issuances	-	-	-	6,254	-
Sales and settlements	(172)	-	-	(46,421)	(110)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	(300)	-
Fixed maturities to short-term investments classification change	-	-	-	-	-
Balance, end of period	$ 17,048	$ -	$ -	$ 114,540	$ (49,645)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 4,878	$ -	$ -	$ 9,285	$ (12,725)

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

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

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

(U.S. dollars in thousands)	Other asset-backed securities	Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported	Short-term investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	$ 16,552	$ -	$ -	$ 113,959	$ (42,644)
Realized gains (losses)	(94)	-	-	2,438	-
Movement in unrealized gains (losses)	3,905	-	-	4,521	6,697
Purchases and issuances	-	-	-	3,682	-
Sales and settlements	(1,118)	-	-	(6,520)	-
Transfers into Level 3	6,003	-	-	-	-
Transfers out of Level 3	-	-	-	(315)	-
Fixed maturities to short-term investments classification change	-	-	-	-	-
Balance, end of period	$ 25,248	$ -	$ -	$ 117,765	$ (35,947)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 3,681	$ -	$ -	$ 1,004	$ 6,697

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

(U.S. dollars in thousands)	Corporate	RMBS - Agency	RMBS - Non Agency	CMBS	CDO
Balance, beginning of period	$ 36,866	$ 30,255	$ 4,964	$ 1,623	$ 721,572
Realized gains (losses)	(279)	-	-	(678)	(1,071)
Movement in unrealized gains (losses)	195	(50)	(16)	514	36,417
Purchases and issuances	6,877	-	-	3,155	2,379
Sales and settlements	(10,049)	(286)	(374)	(51)	(33,944)
Transfers into Level 3	-	-	-	-	1,886
Transfers out of Level 3	(28,824)	(14,534)	(1,380)	-	-
Fixed maturities to short-term investments classification change	-	-	-	-	-
Balance, end of period	$ 4,786	$ 15,385	$ 3,194	$ 4,563	$ 727,239
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 6	$ (50)	$ (16)	$ (152)	$ 33,777

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

(U.S. dollars in thousands)	Other asset-backed securities	Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported	Short-term investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	$ 24,650	$ 3,667	$ -	$ 133,717	$ (39,195)
Realized gains (losses)	(317)	-	-	12,155	-
Movement in unrealized gains (losses)	6,860	-	-	7,492	(10,276)
Purchases and issuances	-	-	-	8,115	-
Sales and settlements	(9,114)	-	-	(46,939)	(174)
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	(5,031)	(3,667)	-	-	-
Fixed maturities to short-term investments classification change	-	-	-	-	-
Balance, end of period	$ 17,048	$ -	$ -	$ 114,540	$ (49,645)
Movement in total gains (losses) above relating to instruments still held at the reporting date	$ 6,193	$ -	$ -	$ 17,337	$ (10,276)

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(c) Fixed maturities and short-term investments

The Company s Level 3 assets consist primarily of CDOs, for which non-binding broker quotes are the primary source of the valuations. Sufficient information regarding the specific inputs utilized by the brokers was not available to support a Level 2 classification. The Company obtains the majority of broker quotes for these CDOs from third party investment managers who perform independent verifications of these valuations using pricing matrices based upon information gathered by market traders. In addition, for the majority of these securities, the Company compares the broker quotes to independent valuations obtained from third party pricing vendors, which may also consist of broker quotes, to assess if the prices received represent a reasonable estimate of the fair value. Although the Company does not have access to the specific unobservable inputs that may have been used in the fair value measurements of the CDO securities provided by brokers, we would expect that the significant inputs considered are prepayment rates, probability of default, loss severity in the event of default, recovery rates, liquidity premium and reinvestment rates. Significant increases (decreases) in any of those inputs in isolation could result in a significantly different fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

The remainder of the Level 3 assets relate to primarily to private equity investments and certain derivative positions as described below.

(d) Other investments

Included within the Other investments component of the Company s Level 3 valuations are private investments and alternative fund investments where the Company is not deemed to have significant influence over the investee. The fair value of these investments is based upon net asset values received from the investment manager or general partner of the respective entity. The nature of the underlying investments held by the investee that form the basis of the net asset value include assets such as private business ventures and are such that significant Level 3 inputs are utilized in the determination of the individual underlying holding values and, accordingly, the fair value of the Company s investment in each entity is classified within Level 3. The Company has not adjusted the net asset values received; however, management incorporates factors such as the most recent financial information received, annual audited financial statements and the values at which capital transactions with the investee take place when applying judgment regarding whether any adjustments should be made to the net asset value in recording the fair value of each position. Investments in alternative funds included in Other investments utilize strategies including arbitrage, directional, event driven and multi-style. These funds potentially have lockup and gate provisions which may limit redemption liquidity. For further details regarding the nature of Other investments and related features see Item 8, Note 7, Other Investments, to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

(e) Derivative instruments

Derivative instruments recorded within Other liabilities and classified within Level 3 include credit derivatives sold providing protection on senior tranches of structured finance transactions where the value is obtained directly from the investment bank counterparty and sufficient information regarding the inputs utilized in such valuation was not obtained to support a Level 2 classification and guaranteed minimum income benefits (GMIB) embedded within one reinsurance contract. The majority of inputs utilized in the valuations of these types of derivative contracts are considered Level 1 or Level 2; however, each valuation includes at least one Level 3 input that was significant to the valuation and, accordingly, the values are disclosed within Level 3.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

(f) Financial Instruments Not Carried at Fair Value

Authoritative guidance over disclosures about the fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, net receivable from investments sold, other assets, net payable for investments purchased, other liabilities and other financial instruments not included below approximated their fair values. The following table includes financial instruments for which the carrying value differs from the estimated fair values at June 30, 2012 and December 31, 2011. All of these fair values estimates are considered Level 2 fair value measurements. The fair values for fixed maturities held to maturity are provided by third party pricing vendors and significant valuation inputs for all other items included were based upon market data obtained from sources independent of the Company.

	June 30, 2012		December 31, 2011	
(U.S. dollars in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturities, held to maturity	$ 2,716,357	$ 3,006,992	$ 2,668,978	$ 2,895,668
Other investments - structured transactions	314,015	289,874	323,705	297,124
Financial Assets	$ 3,030,372	$ 3,296,866	$ 2,992,683	$ 3,192,792
Deposit liabilities	$ 1,600,595	$ 1,876,742	$ 1,608,108	$ 1,809,812
Notes payable and debt	1,673,921	1,820,193	2,275,327	2,340,148
Financial Liabilities	$ 3,274,516	$ 3,696,935	$ 3,883,435	$ 4,149,960

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

Deposit liabilities include obligations under structured insurance and reinsurance transactions. For purposes of fair value disclosures, the Company determined the estimated fair value of the deposit liabilities by assuming a discount rate equal to the appropriate U.S. Treasury rate plus 139.7 basis points at June 30, 2012 and the appropriate U.S. Treasury rate plus 161.8 basis points at December 31, 2011. The discount rate incorporates the Company s own credit risk into the determination of estimated fair value.

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

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

The Company evaluates the performance of both the Insurance and Reinsurance segments based on underwriting profit while the Life operations segment performance is based on contribution. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate investment assets by segment for its Property and Casualty (P&C) operations. Investment assets related to the Company s Life operations and certain structured products included in the Insurance and Reinsurance segments and Corporate are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from the applicable segment.

Three Months Ended June 30, 2012 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Total**
Gross premiums written	$ 1,311,034	$ 452,417	$ 1,763,451	$ 92,904	$ 1,856,355
Net premiums written	944,267	403,011	1,347,278	85,623	1,432,901
Net premiums earned	959,294	441,678	1,400,972	85,623	1,486,595
Net losses and loss expenses	(635,284)	(191,071)	(826,355)	(131,150)	(957,505)
Acquisition costs	(123,284)	(87,723)	(211,007)	(7,930)	(218,937)
Operating expenses (1)	(192,247)	(41,991)	(234,238)	(2,829)	(237,067)
Underwriting profit (loss)	$ 8,479	$ 120,893	$ 129,372	$ (56,286)	$ 73,086
Net investment income	-	-	170,581	74,645	245,226
Net results from structured products (2)	9,047	(22,913)	(13,866)	-	(13,866)
Net fee income and other (3)	(1,847)	990	(857)	42	(815)
Net realized gains (losses) on investments			(2,154)	(10,239)	(12,393)
Contribution from P&C and Life Operations			$ 283,076	$ 8,162	$ 291,238
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					(4,300)
Net income (loss) from investment fund affiliates and operating affiliates (4)					25,658
Exchange gains (losses)					17,976
Corporate operating expenses					(50,061)
Interest expense (5)					(26,089)
Non-controlling interests					(3,454)
Income tax					(29,812)
Net income (loss) attributable to XL Group plc					$ 221,156
Ratios P&C operations: (6)					
Loss and loss expense ratio	66.2%	43.3%	59.0%		
Underwriting expense ratio	32.9%	29.3%	31.8%		
Combined ratio	99.1%	72.6%	90.8%		

(1) Operating expenses exclude Corporate operating expenses, shown separately.
(2) The net results from P&C structured products include net investment income and interest expense of $17.4 million and $31.3 million, respectively.
(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business.
(4) The Company records the income related to the alternative funds and to the private investment and operating fund affiliates on a one-month and three-month lag, respectively.
(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.
(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Three Months Ended June 30, 2011 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Total**
Gross premiums written	$ 1,290,030	$ 472,413	$ 1,762,443	$ 100,281	$ 1,862,724
Net premiums written	893,191	412,868	1,306,059	92,194	1,398,253
Net premiums earned	907,443	398,682	1,306,125	92,214	1,398,339
Net losses and loss expenses	(608,182)	(215,402)	(823,584)	(137,416)	(961,000)
Acquisition costs	(113,883)	(91,448)	(205,331)	(9,768)	(215,099)
Operating expenses (1)	(166,608)	(43,553)	(210,161)	(2,723)	(212,884)
Underwriting profit (loss)	$ 18,770	$ 48,279	$ 67,049	$ (57,693)	$ 9,356
Net investment income	-	-	196,053	82,057	278,110
Net results from structured products (2)	2,690	2,226	4,916	-	4,916
Net fee income and other (3)	(3,218)	(9)	(3,227)	96	(3,131)
Net realized gains (losses) on investments			(10,248)	704	(9,544)
Contribution from P&C and Life Operations			$ 254,543	$ 25,164	$ 279,707
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					(10,950)
Net income (loss) from investment fund affiliates and operating affiliates (4)					56,501
Exchange gains (losses)					8,498
Corporate operating expenses					(39,566)
Interest expense (5)					(41,599)
Non-controlling interests					(2,102)
Income tax					(24,826)
Net income (loss) attributable to XL Group plc					$ 225,663
Ratios P&C operations: (6)					
Loss and loss expense ratio	67.0%	54.0%	63.1%		
Underwriting expense ratio	30.9%	33.9%	31.8%		
Combined ratio	97.9%	87.9%	94.9%		

(1) Operating expenses exclude Corporate operating expenses, shown separately.
(2) The net results from P&C structured products include net investment income and interest expense of $18.4 million and $13.5 million, respectively.
(3)

Net fee income and other includes operating expenses from the Company s loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.

(4) The Company records the income related to the alternative funds and to the private investment and operating fund affiliates on a one-month and three-month lag, respectively.

(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2012 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Total**
Gross premiums written	$ 2,647,668	$ 1,432,767	$ 4,080,435	$ 179,587	$ 4,260,022
Net premiums written	1,980,793	1,329,713	3,310,506	164,119	3,474,625
Net premiums earned	1,893,350	865,520	2,758,870	164,143	2,923,013
Net losses and loss expenses	(1,266,969)	(413,451)	(1,680,420)	(252,457)	(1,932,877)
Acquisition costs	(251,540)	(175,967)	(427,507)	(15,581)	(443,088)
Operating expenses (1)	(377,593)	(80,738)	(458,331)	(5,436)	(463,767)
Underwriting profit (loss)	$ (2,752)	$ 195,364	$ 192,612	$ (109,331)	$ 83,281
Net investment income	-	-	343,549	149,671	493,220
Net results from structured products (2)	11,866	(20,415)	(8,549)	-	(8,549)
Net fee income and other (3)	(3,867)	1,323	(2,544)	90	(2,454)
Net realized gains (losses) on investments			22,813	(14,403)	8,410
Contribution from P&C and Life Operations			$ 547,881	$ 26,027	$ 573,908
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					(3,598)
Net income (loss) from investment fund affiliates and operating affiliates (4)					61,319
Exchange gains (losses)					5,258
Corporate operating expenses					(94,321)
Interest expense (5)					(53,409)
Non-controlling interests					(40,011)
Income tax					(51,362)
Net income (loss) attributable to XL Group plc					$ 397,784
Ratios P&C operations: (6)					
Loss and loss expense ratio	66.9%	47.8%	60.9%		
Underwriting expense ratio	33.2%	29.6%	32.1%		
Combined ratio	100.1%	77.4%	93.0%		

(1) Operating expenses exclude Corporate operating expenses, shown separately.
(2) The net results from P&C structured products include net investment income and interest expense of $34.7 million and $43.2 million, respectively.
(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business.
(4) The Company records the income related to the alternative funds and to the private investment and operating fund affiliates on a one-month and three-month lag, respectively.
(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.
(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2011 *(U.S. dollars in thousands, except ratios)*	**Insurance**	**Reinsurance**	**Total P&C**	**Life Operations**	**Total**
Gross premiums written	$ 2,512,379	$ 1,349,184	$ 3,861,563	$ 197,940	$ 4,059,503
Net premiums written	1,812,181	1,208,160	3,020,341	181,866	3,202,207
Net premiums earned	1,783,363	794,458	2,577,821	181,901	2,759,722
Net losses and loss expenses	(1,396,695)	(635,754)	(2,032,449)	(270,647)	(2,303,096)
Acquisition costs	(221,527)	(164,974)	(386,501)	(17,088)	(403,589)
Operating expenses (1)	(330,703)	(89,183)	(419,886)	(4,889)	(424,775)
Underwriting profit (loss)	$ (165,562)	$ (95,453)	$ (261,015)	$ (110,723)	$ (371,738)
Net investment income	-	-	379,618	159,033	538,651
Net results from structured products (2)	5,950	6,440	12,390	-	12,390
Net fee income and other (3)	(9,130)	1,385	(7,745)	137	(7,608)
Net realized gains (losses) on investments			(37,134)	(38,847)	(75,981)
Contribution from P&C and Life Operations			$ 86,114	$ 9,600	$ 95,714
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					(7,383)
Net income (loss) from investment fund affiliates and operating affiliates (4)					97,287
Exchange gains (losses)					(1,016)
Corporate operating expenses					(75,258)
Interest expense (5)					(83,498)
Non-controlling interests					(35,438)
Income tax					7,971
Net income (loss) attributable to XL Group plc					$ (1,621)
Ratios P&C operations: (6)					
Loss and loss expense ratio	78.3%	80.0%	78.8%		
Underwriting expense ratio	31.0%	32.0%	31.3%		
Combined ratio	109.3%	112.0%	110.1%		

(1) Operating expenses exclude Corporate operating expenses, shown separately.
(2) The net results from P&C structured products include net investment income and interest expense of $38.1 million and $25.7 million, respectively.
(3) Net fee income and other includes operating expenses from the Company s loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
(4)

The Company records the income related to the alternative funds and to the private investment and operating fund affiliates on a one-month and three-month lag, respectively.

(5) Interest expense excludes interest expense related to deposit liabilities recorded in the Insurance and Reinsurance segments.

(6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

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

Three Months Ended June 30, 2012 *(U.S. dollars in thousands)*	**Insurance**	**Reinsurance**	**Life Operations**	**Total**
P&C Operations:				
Casualty - professional lines	$ 330,876	$ 53,303	$ -	$ 384,179
Casualty - other lines	167,562	76,842	-	244,404
Property catastrophe	-	113,221	-	113,221
Other property	124,893	145,025	-	269,918
Marine, energy, aviation and satellite	143,981	35,627	-	179,608
Other specialty lines (1)	190,169	-	-	190,169
Other (2)	1,813	17,660	-	19,473
Total P&C Operations	$ 959,294	$ 441,678	$ -	$ 1,400,972
Life Operations:				
Annuity	$ -	$ -	$ 31,243	$ 31,243
Other Life	-	-	54,380	54,380
Total Life Operations	$ -	$ -	$ 85,623	$ 85,623
Total	$ 959,294	$ 441,678	$ 85,623	$ 1,486,595

Three Months Ended June 30, 2011 *(U.S. dollars in thousands)*				
P&C Operations:				
Casualty - professional lines	$ 322,654	$ 51,915	$ -	$ 374,569
Casualty - other lines	172,246	68,920	-	241,166
Property catastrophe	-	94,363	-	94,363
Other property	117,088	135,255	-	252,343
Marine, energy, aviation and satellite	128,358	30,436	-	158,794
Other specialty lines (1)	165,027	-	-	165,027
Other (2)	2,070	17,793	-	19,863
Total P&C Operations	$ 907,443	$ 398,682	$ -	$ 1,306,125
Life Operations:				
Annuity	$ -	$ -	$ 33,968	$ 33,968
Other Life	-	-	58,246	58,246
Total Life Operations	$ -	$ -	$ 92,214	$ 92,214
Total	$ 907,443	$ 398,682	$ 92,214	$ 1,398,339

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Segment Information

Six Months Ended June 30, 2012 *(U.S. dollars in thousands)*	**Insurance**	**Reinsurance**	**Life Operations**	**Total**
P&C Operations:				
Casualty - professional lines	$ 654,696	$ 108,209	$ -	$ 762,905
Casualty - other lines	334,920	150,080	-	485,000
Property catastrophe	-	216,146	-	216,146
Other property	258,312	280,769	-	539,081
Marine, energy, aviation and satellite	264,081	71,371	-	335,452
Other specialty lines (1)	374,203	-	-	374,203
Other (2)	7,138	38,945	-	46,083
Total P&C Operations	$ 1,893,350	$ 865,520	$ -	$ 2,758,870
Life Operations:				
Annuity	$ -	$ -	$ 62,700	$ 62,700
Other Life	-	-	101,443	101,443
Total P&C Operations	$ -	$ -	$ 164,143	$ 164,143
Total	$ 1,893,350	$ 865,520	$ 164,143	$ 2,923,013

Six Months Ended June 30, 2011 *(U.S. dollars in thousands)*				
P&C Operations:				
Casualty - professional lines	$ 638,297	$ 105,632	$ -	$ 743,929
Casualty - other lines	328,950	119,963	-	448,913
Property catastrophe	-	188,927	-	188,927
Other property	224,009	271,498	-	495,507
Marine, energy, aviation and satellite	253,893	68,864	-	322,757
Other specialty lines (1)	333,693	-	-	333,693
Other (2)	4,521	39,574	-	44,095
Total P&C Operations	$ 1,783,363	$ 794,458	$ -	$ 2,577,821
Life Operations:				
Annuity	$ -	$ -	$ 66,891	$ 66,891
Other Life	-	-	115,010	115,010
Total P&C Operations	$ -	$ -	$ 181,901	$ 181,901
Total	$ 1,783,363	$ 794,458	$ 181,901	$ 2,759,722

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

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

Amortized Cost and Fair Value Summary

The cost (amortized cost for fixed maturities and short-term investments), fair value, gross unrealized gains and gross unrealized (losses), including, other-than-temporary impairments (OTTI) recorded in accumulated other comprehensive income (AOCI) of the Company s available for sale (AFS) and held to maturity (HTM) investments at June 30, 2012 and December 31, 2011 were as follows:

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

(1) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of $2,012.4 million and fair value of $2,066.0 million and U.S. Agencies with an amortized cost of $455.0 million and fair value of $500.5 million.

(2) At June 30, 2012, Covered Bonds within Fixed maturities AFS with an amortized cost of $478.1 million and a fair value of $500.5 million and Covered Bonds within Fixed maturities HTM with an amortized cost of $8.1 million and a fair value of $7.8 million have been included within Other asset-backed securities to align the Company s classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.

(3) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of $186.1 million and an amortized cost of $199.1 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(4) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of $346.2 million and an amortized cost of $420.3 million at June 30, 2012.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

December 31, 2011 *(U.S. dollars in thousands)*	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Included in AOCI** **Gross Unrealized Losses** **Related to Changes in Estimated Fair Value**	**Non-credit Related OTTI**	**Fair Value**
Fixed maturities - AFS					
U.S. Government and Government-Related/Supported (1)	$ 1,864,354	$ 130,874	$ (4,245)	$ -	$ 1,990,983
Corporate (2) (3) (4)	9,866,677	527,192	(233,581)	(51,666)	10,108,622
RMBS Agency	5,189,473	193,782	(3,849)	-	5,379,406
RMBS Non-Agency	851,557	19,667	(112,867)	(116,542)	641,815
CMBS	927,684	56,704	(2,405)	(7,148)	974,835
CDO	843,553	6,624	(186,578)	(4,997)	658,602
Other asset-backed securities (2)	1,341,309	30,731	(25,486)	(6,305)	1,340,249
U.S. States and political subdivisions of the States	1,698,573	101,025	(2,220)	-	1,797,378
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (1)	3,188,535	127,439	(17,839)	-	3,298,135
Total fixed maturities - AFS	$ 25,771,715	$ 1,194,038	$ (589,070)	$ (186,658)	$ 26,190,025
Total short-term investments (1)	$ 359,378	$ 519	$ (834)	$ -	$ 359,063
Total equity securities	$ 480,685	$ 27,947	$ (40,435)	$ -	$ 468,197
Total investments - AFS	$ 26,611,778	$ 1,222,504	$ (630,339)	$ (186,658)	$ 27,017,285
Fixed maturities - HTM					
U.S. Government and Government-Related/Supported (2)	$ 10,399	$ 1,510	$ -	$ -	$ 11,909
Corporate (2)	1,290,209	91,313	(14,433)	-	1,367,089
RMBS Non-Agency	80,955	6,520	(32)	-	87,443
Other asset-backed securities (2)	288,741	20,875	(320)	-	309,296
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (1)	998,674	127,227	(5,950)	-	1,119,951
Total investments - HTM	$ 2,668,978	$ 247,445	$ (20,735)	$ -	$ 2,895,688

(1) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of $1,878.3 million and fair value of $1,915.6 million and U.S. Agencies with an amortized cost of $494.0 million and fair value of $541.2 million.

(2) Covered Bonds within Fixed maturities AFS with an amortized cost of $345.4 million and a fair value of $353.9 million and Covered Bonds within Fixed maturities HTM with an amortized cost of $8.1 million and a fair value of $7.7 million at December 31, 2011 have been reclassified from Corporate to Other asset-backed securities to align the Company s classification to market indices and conform to current period presentation.

(3)

Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of $266.0 million and an amortized cost of $297.7 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(4) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of $386.1 million and an amortized cost of $494.9 million at December 31, 2011.

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

Classification of Fixed Income Securities

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

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

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

Covered Bonds were included within Corporate securities prior to January 1, 2012. They are now classified as Other asset-backed securities to align the Company s classification to market indices. At December 31, 2011, Covered Bonds with a fair value of $353.9 million have been reclassified from Corporate to Other asset-backed securities to conform to current period presentation.

Contractual Maturities Summary

The contractual maturities of AFS and HTM fixed income securities at June 30, 2012 and December 31, 2011 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

(U.S. dollars in thousands)	June 30, 2012 (1) Amortized Cost	June 30, 2012 (1) Fair Value	December 31, 2011 (1) Amortized Cost	December 31, 2011 (1) Fair Value
Fixed maturities - AFS				
Due less than one year	$ 1,983,583	$ 1,999,239	$ 2,004,395	$ 2,020,361
Due after 1 through 5 years	7,976,631	8,243,009	7,736,717	7,909,354
Due after 5 through 10 years	3,401,824	3,610,915	3,619,141	3,777,073
Due after 10 years	3,320,524	3,640,235	3,257,886	3,488,330
	$ 16,682,562	$ 17,493,398	$ 16,618,139	$ 17,195,118
RMBS Agency	5,001,023	5,202,313	5,189,473	5,379,406
RMBS Non-Agency	728,309	584,543	851,557	641,815
CMBS	842,802	904,792	927,684	974,835
CDO	796,018	650,018	843,553	658,602
Other asset-backed securities	1,392,065	1,407,738	1,341,309	1,340,249
Total mortgage and asset-backed securities	$ 8,760,217	$ 8,749,404	$ 9,153,576	$ 8,994,907
Total fixed maturities - AFS	$ 25,442,779	$ 26,242,802	$ 25,771,715	$ 26,190,025
Fixed maturities - HTM				
Due less than one year	$ 30,847	$ 31,138	$ 11,796	$ 11,768
Due after 1 through 5 years	165,678	172,104	122,091	123,871
Due after 5 through 10 years	365,103	386,251	393,865	402,424
Due after 10 years	1,843,808	2,079,157	1,771,530	1,960,886
	$ 2,405,436	$ 2,668,650	$ 2,299,282	$ 2,498,949
RMBS Non-Agency	81,028	87,090	80,955	87,443
CMBS	12,546	14,213	-	-
Other asset-backed securities	217,347	237,039	288,741	309,296
Total mortgage and asset-backed securities	$ 310,921	$ 338,342	$ 369,696	$ 396,739
Total fixed maturities - HTM	$ 2,716,357	$ 3,006,992	$ 2,668,978	$ 2,895,688

(1) Included in the table above are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions, at their fair value of $346.2 million and $386.1 million at June 30, 2012 and December 31, 2011, respectively. These securities are reflected in the table based on their call date and have net unrealized losses of $74.7 million and $108.8 million at June 30, 2012 and December 31, 2011, respectively.

OTTI Considerations

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

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

Pledged Assets

Certain of the Company s invested assets are held in trust and pledged in support of insurance and reinsurance liabilities as well as credit facilities. Such pledges are largely required by the Company s operating subsidiaries that are non-admitted under U.S. state insurance regulations, in order for the U.S. cedant to receive statutory credit for reinsurance. Also, certain deposit liabilities and annuity contracts require the use of pledged assets. At June 30, 2012 and December 31, 2011, the Company had $17.5 billion and $17.2 billion in pledged assets, respectively.

(b) Gross Unrealized Losses

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

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

(1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, have a fair value of $186.1 million and an amortized cost of $199.1 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(2) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities, which are in a gross unrealized loss position, have a fair value of $346.2 million and an amortized cost of $420.3 million at June 30, 2012.

(3) Covered Bonds within Fixed maturities and short-term investments AFS with a fair value of $34.3 million and Covered Bonds within Fixed Maturities HTM with a fair value of $8.1 million have been included within Other asset-backed securities to align the Company s classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.

(4) Included within equity securities are investments in fixed income funds with a fair value of $95.8 million and an amortized cost of $100.0 million at June 30, 2012.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

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

(1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes, which are in a gross unrealized loss position, have a fair value of $266.0 million and an amortized cost of $297.7 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

(2) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities, which are in a gross unrealized loss position, have a fair value of $386.1 million and an amortized cost of $494.9 million at December 31, 2011.

(3) Covered Bonds within Fixed maturities and short-term investments AFS with a fair value of $44.7 million and Covered Bonds within Fixed Maturities HTM with a fair value of $7.7 million have been included within Other asset-backed securities to align the Company s classification to market indices and to conform to current period presentation. Covered Bonds were included in Corporate prior to January 1, 2012.

(4) Included within equity securities are investments in fixed income funds with a fair value of $91.6 million and an amortized cost of $100.0 million at December 31, 2011.

The Company had gross unrealized losses totaling $576.8 million on 1,308 securities out of a total of 7,156 held at June 30, 2012 in its AFS portfolio and $12.5 million on 15 securities out of a total of 208 held in its HTM portfolio, which it considers to be temporarily impaired or with respect to which reflects non-credit losses on OTTI. Individual security positions comprising this balance have been evaluated by management to determine the severity of these impairments and whether they should be considered other-than-temporary. Management believes it is more likely than not that the issuer will be able to fund sufficient principal and interest payments to support the current amortized cost.

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

(c) Net Realized Gains (Losses)

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

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

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

§ $14.3 million for structured securities where the Company determined that the likely recovery on these securities was below the carrying value and, accordingly, recorded an impairment of the securities to the discounted value of the cash flows expected to be received on these securities.

§ $10.2 million related to medium term notes backed primarily by European investment grade credit. On certain notes, management concluded that future returns on the underlying assets were not sufficient to support the previously reported amortized cost. The Company also adjusted the estimated remaining holding period of certain notes resulting in a shorter reinvestment spectrum.

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

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

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

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

Balance at June 30,	$	299,720	$	315,844	$	299,720	$	315,844

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. Investments

(d) Other Investments

Structured Transactions - Project Finance Loans

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

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

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

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

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

Investment Fund Consolidation

During May 2012, the Company invested $25.0 million to obtain a 94% interest in Five Oaks Investment Corp. (Five Oaks), a newly formed private investment company. Five Oaks is a mortgage real estate investment trust that is expected to follow an investment strategy balancing a leveraged portfolio of Agency RMBS with an unlevered or moderately levered portfolio of non-Agency RMBS. Five Oaks may enter into repurchase agreements to acquire investment leverage up to a maximum of $79.5 million. At June 30, 2012, the Company has consolidated Five Oaks resulting in the recording within its balance sheet of: RMBS securities at their fair value of $80.7 million (amortized cost: $80.6 million) within Fixed maturities, $14.9 million of Cash and cash equivalents, $69.1 million of liabilities related to obligations under repurchase agreements within Other liabilities, and $1.5 million of Non-controlling interest in equity of consolidated subsidiaries. $75.6 million of securities held by Five Oaks and consolidated by XL are pledged as collateral under the repurchase agreements. The repurchase agreements do not provide the counterparties any recourse to assets of XL aside from its investment in Five Oaks. Amounts recorded within the Company s consolidated statement of income related to Five Oaks were immaterial during the three and six month periods ended June 30, 2012. In addition, the Company has purchased an equity interest in Oak Circle Capital Partners (Oak Circle), the investment management company that provides portfolio management and other administrative services to Five Oaks. XL s investment in Oak Circle has been accounted for using the equity method consistent with other investment manager affiliate positions held by the Company.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

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

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

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

(1) Derivative instruments in an asset or liability position are included within Other assets or Other liabilities, respectively, in the balance sheet on a net basis where the Company has both a legal right of offset and the intentions to settle the contracts on a net basis.

(2) At June 30, 2012 and December 31, 2011, the Company held net cash collateral related to these derivative positions of $124.7 million and $77.1 million, respectively. The collateral balance is included within Cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative asset within the balance sheet as appropriate under the netting agreement.

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(a) Derivative Instruments Designated as Fair Value Hedges

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

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

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

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

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

Settlement of Fair Value Hedges

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

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

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

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

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

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(c) Derivative Instruments Not Formally Designated As Hedging Instruments

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

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

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

(d)(i) Investment Related Derivatives

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

Investment Related Derivatives Interest Rate Exposure

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

Investment Related Derivatives Foreign Exchange Exposure

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

Investment Related Derivatives Credit Exposure

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

Investment Related Derivatives Financial Market Exposure

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

(d)(ii) Financial Operations Derivatives Credit Exposure

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

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

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

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

(d)(iii) Other Non-Investment Derivatives

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

35

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Derivative Instruments

(e) Contingent Credit Features

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

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

7. Share Capital

(a) Authorized and Issued

Ordinary Share Buybacks

On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to $750 million of its ordinary shares. This authorization replaced the approximately $190 million remaining under the share buyback program that was authorized in November 2010 as described in further detail in Item 8, Note 18, Share Capital, to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares under the new program for $100.0 million and $125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company s constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, $525.0 million remained available for purchase under the new program.

(b) Stock Plans

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

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

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

During the six months ended June 30, 2012, the Company granted approximately 0.3 million restricted stock awards to certain employees and directors of the Company and its subsidiaries with an aggregate grant date fair value of approximately $6.8 million. The award recipients generally have the rights and privileges of a shareholder as to the restricted stock, including the right to receive dividends and the right to vote such restricted stock. The recipients are not entitled to receive delivery of a stock certificate prior to vesting nor may any restricted stock be sold, transferred, pledged, or otherwise disposed of prior to the satisfaction of all vesting requirements.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

7. Share Capital

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

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

8. Notes Payable and Debt and Financing Arrangements

(a) Notes Payable and Debt

All outstanding debt of the Company at June 30, 2012 and December 31, 2011 was issued by XLIT Ltd. (XL-Cayman) except for the $600 million par value 6.5% Guaranteed Senior Notes (the XLCFE Notes), which were issued by XL Capital Finance (Europe) plc (XLCFE) and were repaid at maturity on January 15, 2012. Both XL-Cayman and XLCFE are wholly-owned subsidiaries of XL Group plc. The XLCFE Notes were fully and unconditionally guaranteed by XL Company Switzerland GmbH. XL-Cayman s outstanding debt is fully and unconditionally guaranteed by XL-Ireland. The Company s ability to obtain funds from its subsidiaries to satisfy any of its obligations under guarantees is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates, including, among others, Bermuda, the United States, Ireland, Switzerland and the U.K. Aggregated required statutory capital and surplus for the principal operating subsidiaries of the Company was $6.7 billion at December 31, 2011.

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

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

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

(1) At June 30, 2012 and December 31, 2011, there were five available letter of credit facilities.
(2) At June 30, 2012 and December 31, 2011, the revolving credit facility was unutilized.
(3) The Company has the option to increase the size of the March 2011 Credit Agreement by an additional $500 million and the size of the facilities under the December 2011 Credit Agreements by an additional $500 million across both such facilities..

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Related Party Transactions

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

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

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

10. Variable Interest Entities

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

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

The Company has a limited number of remaining outstanding credit enhancement exposures, including written financial guarantee and credit default swap contracts. The obligations related to these transactions are often securitized through VIEs. The Company is not the primary beneficiary of these VIEs as contemplated in current authoritative accounting guidance on the basis that management does not believe that the Company has the power to direct the activities, such as asset selection and collateral management, which most significantly impact each entity s economic performance. For further details on the nature of the obligations and the size of the Company s maximum exposure, see Note 6, Derivative Instruments, and Note 12 (a), Commitments and Contingencies Financial Guarantee Exposures.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

12. Commitments and Contingencies

(a) Financial Guarantee Exposures

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

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

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

(b) Claims and Other Litigation

The Company and its subsidiaries are subject to litigation and arbitration in the normal course of business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company s loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to litigation relating to insurance and reinsurance claims, the Company and its subsidiaries are subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on insurance or reinsurance policies. This category of business litigation typically involves, among other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes or disputes arising from business ventures. The status of these legal actions is actively monitored by management.

Legal actions are subject to inherent uncertainties, and future events could change management s assessment of the probability or estimated amount of potential losses from pending or threatened legal actions. Based on available information, it is the opinion of management that the ultimate resolution of pending or threatened legal actions, both individually and in the aggregate, will not result in losses having a material effect on the Company s financial position or liquidity at June 30, 2012.

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

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

GENERAL

On July 1, 2010, XL Group plc, an Irish public limited company (XL-Ireland), and XL Group Ltd. (now known as XLIT Ltd.), a Cayman Islands exempted company (XL-Cayman), completed a redomestication transaction in which all of the ordinary shares of XL-Cayman were exchanged for all of the ordinary shares of XL-Ireland (the Redomestication). As a result, XL-Cayman became a wholly owned subsidiary of XL-Ireland. Prior to July 1, 2010, unless the context otherwise indicates, references in this Management s Discussion and Analysis of Financial Condition and Results of Operations to the Company are to XL-Cayman and its consolidated subsidiaries. On and subsequent to July 1, 2010, unless the context otherwise indicates, references herein to the Company are to XL-Ireland and its consolidated subsidiaries.

The following is a discussion of the Company s financial condition and liquidity and results of operations. Certain aspects of the Company s business have loss experience characterized as low frequency and high severity. This may result in volatility in both the Company s and an individual segment s results of operations and financial condition.

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve inherent risks and uncertainties. Statements that are not historical facts, including statements about the Company s beliefs and expectations, are forward-looking statements. These statements are based upon current plans, estimates and expectations. Actual results may differ materially from those projected in such forward-looking statements, and therefore undue reliance should not be placed on them. See Cautionary Note Regarding Forward-Looking Statements for a list of additional factors that could cause actual results to differ materially from those contained in any forward-looking statement, as well as Item 1, Risk Factors, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

This discussion and analysis should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited Consolidated Financial Statements and Notes thereto, presented under Item 7 and Item 8, respectively, of the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

EXECUTIVE OVERVIEW

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

RESULTS OF OPERATIONS AND KEY FINANCIAL MEASURES

Results of Operations

The following table presents an analysis of the Company s net income available to ordinary shareholders and other financial measures (described below) for the three and six months ended June 30, 2012 and 2011:

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

Key Financial Measures

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

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

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

(1) Net investment income relating to P&C operations includes the net investment income related to the net results from structured products.

(2) Annualized return on average ordinary shareholders equity (ROE) is a non-GAAP financial measure and is calculated by dividing the net income (loss) for the year by the average of the opening and closing ordinary shareholders equity. See Annualized Return on Ordinary Shareholders Equity Calculation herein for a reconciliation of ROE to average ordinary shareholders equity.

(3) Book value per ordinary share, a non-GAAP financial measure, is calculated by dividing ordinary shareholders equity (total shareholders equity less non-controlling interest in equity of consolidated subsidiaries) by the number of outstanding ordinary shares at the applicable period end. Book value per ordinary share is affected primarily by the Company s net income (loss), by any changes in the net unrealized gains and losses on its investment portfolio, by currency translation adjustments and also by the impact of any share buyback or issuance activity. Ordinary shareholders equity was $9.9 billion and $9.4 billion and the number of ordinary shares outstanding was 305.7 million and 315.7 million at June 30, 2012 and December 31, 2011, respectively. Ordinary shares outstanding include all ordinary shares legally issued and outstanding (as disclosed on the face of the balance sheet) as well as all director share units outstanding.

(4) Fully diluted book value per ordinary share, a non-GAAP financial measure, represents book value per ordinary share combined with the dilutive impact of potential future share issuances at period end. The Company believes that book value per share and fully diluted book value per ordinary share are financial measures important to investors and other interested parties. However, these measures may not be comparable to similarly titled measures used by companies either outside or inside of the insurance industry.

Underwriting profit property and casualty (P&C) operations

One way that the Company evaluates the performance of its insurance and reinsurance operations is by underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned less net losses incurred and expenses related to underwriting activities. The Company s underwriting profit for the three and six months ended June 30, 2012 was consistent with the combined ratio discussed below.

Combined ratio P&C operations

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

Net investment income P&C operations

Net investment income related to P&C operations is an important measure that affects the Company s overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Company s investment portfolio provides liquidity for claims settlements of these reserves as they become due. As a result, a significant part of the investment portfolio is invested in fixed income securities. Net investment income is influenced by a number of factors, including the amounts and timing of inward and outward cash flows, the level of interest rates and credit spreads and changes in overall asset allocation.

Book value per ordinary share

Management also views the change in the Company s book value per ordinary share as an additional measure of the Company s performance. Book value per ordinary share, a non-GAAP financial measure, is calculated by dividing ordinary shareholders equity (total shareholders equity less non-controlling interest in equity of consolidated subsidiaries) by the number of outstanding ordinary shares at the applicable period end. Book value per ordinary share is affected primarily by the Company s net income (loss), by any changes in the net unrealized gains and losses on its investment portfolio, currency translation adjustments and also the impact of any share buyback or issuance activity. Ordinary shareholders equity was $9.9 billion and $9.4 billion and the number of ordinary shares outstanding was 305.7 million and 315.6 million at June 30, 2012 and December 31, 2011, respectively. Ordinary shares outstanding include all ordinary shares legally issued and outstanding (as disclosed on the face of the balance sheet) as well as all director share units outstanding.

Book value per ordinary share increased by $1.13 in the three months ended June 30, 2012 and by $2.46 in the six months ended June 30, 2012. These increases were due to the net income in both periods, an increase in net unrealized gains on investments and the benefit of share buyback activity. In the three months ended June 30, 2011 and the six months ended June 30, 2011, book value per share increased by $1.59 and $1.17, respectively, due to an increase in net unrealized gains on available for sale investments and the benefit of share buyback activity offset by catastrophe losses in the first quarter of 2011.

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

***Annualized return on average ordinary shareholders equity* (ROE)**

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

SIGNIFICANT ITEMS AFFECTING THE RESULTS OF OPERATIONS

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

1) the impact of significant large loss events;

2) market movement impacts on the Company s investment portfolio; and

3) continuing competitive factors impacting the underwriting environment.

1) The impact of significant large loss events

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

Natural Catastrophe Losses

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

For the six months ended June 30, 2012, natural catastrophe losses net of reinsurance recoveries and including reinstatement premiums were $80.6 million, compared to $455.7 million in the same period of 2011. Natural catastrophe losses in the first half of 2011 included the March 11, 2011 earthquake and tsunami in Japan, the earthquake that struck Christchurch, New Zealand on February 22, 2011, the 2011 flooding events in Australia and the severe weather occurrences, including tornado activity, in the United States over the periods April 22 - 28 and May 20 - 23, 2011.

Large Loss Events

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

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

2) Market movement impacts on the Company s investment portfolio

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

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

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

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

(1) Source: Bloomberg Finance L.P.

(2) Source: Merrill Lynch Global Indices.

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

During the six months ended June 30, 2012, credit spreads tightened combined with decreasing interest rates. The net impact of the market conditions on the Company s investment portfolio for the six-month period was favorable and resulted in an increase in the amount of $369.9 million in net unrealized gains on available for sale investments as compared to December 31, 2011. This represents an approximately 0.8% appreciation in average assets for the six months ended June 30, 2012.

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

	Interest Rate Movement for the six months ended June 30, 2012 (1) (+ / - represents increases / decreases in interest rates)	Credit Spread Movement for the six months ended June 30, 2012 (2) (+ / - represents widening / tightening of credit spreads)
United States	-11 basis points (5 year Treasury)	-52 basis points (US Corporate A rated)
		-7 basis points (US Mortgage Master Index)
		-58 basis points (US CMBS, AAA rated)
United Kingdom	-15 basis points (10 year Gilt)	-17 basis points (UK Corporate, AA rated)
Euro-zone	-24 basis points (5 year Bund)	-85 basis points (Europe Corporate, A rated)

(1) Source: Bloomberg Finance L.P.
(2) Source: Merrill Lynch Global Indices.

Net realized gains on investments in the six months ended June 30, 2012 totaled $8.4 million, including net realized losses of approximately $49.2 million related to the impairment of certain of the Company s fixed income investments, where the Company determined that there was an other-than-temporary decline in the value of those investments related to credit. For further analysis of this, see Results of Operations below.

3) Continuing competitive factors impacting the underwriting environment

Insurance

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

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

Reinsurance

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

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

There can be no assurance, however, that such (re)insurance rate conditions or growth opportunities will be sustained or further materialize, or lead to improvements in our books of business. See Cautionary Note Regarding Forward-Looking Statements. The Company continues its disciplined underwriting approach to grow on a very selective basis and exit lines where margins are unacceptable.

OTHER KEY FOCUSES OF MANAGEMENT

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

Capital Management

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

Buybacks of Ordinary Shares

On February 27, 2012, the Company announced that its Board of Directors approved a share buyback program, authorizing the Company to purchase up to $750 million of its ordinary shares. This authorization replaced the approximately $190 million remaining under the share buyback program that was authorized in November 2010 as described in further detail in Item 8, Note 18, Share Capital, to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. During the three months ended March 31, 2012 and the three months ended June 30, 2012, the Company purchased and canceled 4.7 million and 6.1 million ordinary shares, respectively, under the new program for $100.0 million and $125.0 million, respectively. All share buybacks were carried out by way of redemption in accordance with Irish law and the Company s constitutional documents. All shares so redeemed were canceled upon redemption. At June 30, 2012, $525.0 million remained available for purchase under the new program.

Repayment of the 6.5% Guaranteed Senior Notes due January 2012 (the XLCFE Notes)

On January 15, 2012, the $600 million principal amount outstanding on the XLCFE Notes, which were issued by XL Capital Finance (Europe) plc (XLCFE), was repaid at maturity. For further detail, see Item 1, Note 8, Notes Payable and Debt Financing Arrangements, to the Unaudited Consolidated Financial Statements included herein.

Risk Management

The Company s risk management and risk appetite framework is detailed in Item 1, Business - Enterprise Risk Management, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. The table below shows the Company s estimated per event net 1% and 0.4% exceedance probability exposures for certain peak natural catastrophe peril regions. These estimates assume that amounts due from reinsurance and retrocession purchases are 100% collectible. There may be credit or other disputes associated with these potential receivables. Finally, the probable maximum losses in the table below were derived by application of a vendor model that was released during the first quarter of 2011 and, accordingly, could be more unreliable than the model that was used historically.

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

(1) Detailed analyses of aggregated in-force exposures and maximum loss levels are done periodically. The measurement dates represent the date of the last completed detailed analysis by geographical zone.

(2)

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

VARIABLE INTEREST ENTITIES AND OTHER OFF-BALANCE SHEET ARRANGEMENTS

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

SEGMENTS

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

The Company evaluates the performance of both the Insurance and Reinsurance segments based on underwriting profit and the performance of the Life operations segment based on its contribution to net income. Other items of revenue and expenditure of the Company are not evaluated at the segment level for reporting purposes. In addition, the Company does not allocate investment assets by segment for its P&C operations. Investment assets related to the Company s Life operations and certain structured products included in the Insurance and Reinsurance segments are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from the applicable segment. See Item 1, Note 4, Segment Information, to the Unaudited Consolidated Financial Statements included herein for a reconciliation of segment data to the Company s Unaudited Consolidated Financial Statements.

INCOME STATEMENT ANALYSIS

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

Insurance

The Company s Insurance segment provides commercial property, casualty and specialty insurance products on a global basis. Products generally provide tailored coverages for complex corporate risks and include the following lines of business: property, casualty, professional liability, environmental liability, aviation and satellite, marine and offshore energy, equine, fine art and specie, excess and surplus lines, political risk and trade credit, product recall, surety and other insurance coverages including those mentioned above, through the Company s program business. The Company focuses on those lines of business within its insurance operations that are believed to provide the best return on capital over time. These lines of business are divided into the following business groups: NAPC, IPC, Global Professional Lines (Professional) and Global Specialty (Specialty).

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

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

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

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

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

The following table presents the ratios for the Insurance segment:

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

The loss and loss expense ratio includes net losses incurred for both the current quarter and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year. The following table summarizes the net (favorable) adverse prior year development relating to the Insurance segment for the three months ended June 30, 2012 as compared to the same period of 2011:

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

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

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

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

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

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

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

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

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

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

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

Reinsurance

The Company s Reinsurance segment provides casualty, property risk, property catastrophe, marine, aviation and other specialty reinsurance on a global basis with business being written on both a proportional and non-proportional treaty basis and also on a facultative basis. The reinsurance operations are structured into geographical business groups: North America, Bermuda, International (Europe and Asia Pacific) and Latin America.

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

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

* NM - Not Meaningful

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

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

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

The following table presents the ratios for the Reinsurance segment:

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

The loss and loss expense ratio includes net losses incurred for both the current year and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year. The following table summarizes the net (favorable) adverse prior year development relating to the Reinsurance segment for the three months ended June 30, 2012 and 2011:

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

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