

XL GROUP PLC
Form 10-Q
May 09, 2011

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

FORM 10-Q

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from ____ to ____

Commission file number 1-10804

XL GROUP

Public Limited Company

(Exact name of registrant as specified in its charter)

Ireland
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

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

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

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

Yes No

As of May 5, 2011, there were 309,415,211 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

XL GROUP PLC

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL GROUP PLC

CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31, 2011	December 31, 2010
<i>(U.S. dollars in thousands, except share data)</i>		
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2011, \$25,013,905; 2010, \$25,714,886)	\$ 24,870,615	\$ 25,544,179
Equity securities, at fair value (cost: 2011, \$235,470; 2010, \$56,737)	270,992	84,767
Short-term investments, at fair value (amortized cost: 2011, \$2,379,789; 2010, \$2,058,447)	2,376,783	2,048,607
	<u>27,518,390</u>	<u>27,677,553</u>
Total investments available for sale	27,518,390	27,677,553
Fixed maturities, held to maturity at amortized cost (fair value: 2011, \$2,773,590; 2010, \$2,742,626)	\$ 2,828,108	\$ 2,728,335
Investments in affiliates	1,028,259	1,069,028
Other investments	977,695	951,723
	<u>32,352,452</u>	<u>32,426,639</u>
Total investments	32,352,452	32,426,639
Cash and cash equivalents	3,385,805	3,022,868
Accrued investment income	327,308	350,091
Deferred acquisition costs	707,681	633,035
Ceded unearned premiums	721,163	625,654
Premiums receivable	2,943,211	2,414,912
Reinsurance balances receivable	178,154	171,327
Unpaid losses and loss expenses recoverable	3,588,935	3,671,887
Net receivable from investments sold		21,716
Goodwill and other intangible assets	842,054	839,508
Deferred tax asset	162,513	143,525
Other assets	672,865	702,189
	<u>\$ 45,882,141</u>	<u>\$ 45,023,351</u>
Total assets	\$ 45,882,141	\$ 45,023,351
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	\$ 20,776,958	\$ 20,531,607
Deposit liabilities	1,670,609	1,684,606
Future policy benefit reserves	5,224,984	5,075,127
Unearned premiums	4,074,090	3,484,830
Notes payable and debt	2,462,917	2,464,410
Reinsurance balances payable	351,181	122,250
Net payable for investments purchased	33,769	34,315
Deferred tax liability	82,287	105,667
Other liabilities	865,200	835,590
	<u>\$ 35,541,995</u>	<u>\$ 34,338,402</u>
Total liabilities	\$ 35,541,995	\$ 34,338,402
Commitments and Contingencies		
Non-controlling interest - Redeemable Series C preference ordinary shares, 20,000,000 authorized, par value \$0.01; Issued and outstanding: (2011, 2,846,000; 2010, 2,876,000)	\$ 71,150	\$ 71,900

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Shareholders' Equity:		
Ordinary shares, 999,990,000 authorized, par value \$0.01; Issued and outstanding: (2011, 309,361,883; 2010, 316,396,289)	3,094	3,165
Additional paid in capital	8,836,764	8,993,016
Accumulated other comprehensive income	175,098	100,795
Retained earnings	252,242	513,777
	<hr/>	<hr/>
Shareholders' equity attributable to XL Group plc	\$ 9,267,198	\$ 9,610,753
Non-controlling interest in equity of consolidated subsidiaries	1,001,798	1,002,296
	<hr/>	<hr/>
Total shareholders' equity	\$ 10,268,996	\$ 10,613,049
	<hr/>	<hr/>
Total liabilities, redeemable preference ordinary shares and shareholders' equity	\$ 45,882,141	\$ 45,023,351
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See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF INCOME

	(Unaudited) Three Months Ended March 31,	
	2011	2010
<i>(U.S. dollars in thousands, except per share data)</i>		
Revenues:		
Net premiums earned	\$ 1,361,383	\$ 1,368,485
Net investment income	280,263	308,324
Realized investment gains (losses):		
Net realized gains (losses) on investments sold	(28,992)	4,021
Other-than-temporary impairments on investments	(33,720)	(60,514)
Other-than-temporary impairments on investments transferred to (from) other comprehensive income	(3,725)	20,317
Total net realized gains (losses) on investments	(66,437)	(36,176)
Net realized and unrealized gains (losses) on derivative instruments	3,567	(20,480)
Income (loss) from investment fund affiliates	27,150	8,178
Fee income and other	8,932	8,418
Total revenues	\$ 1,614,858	\$ 1,636,749
Expenses:		
Net losses and loss expenses incurred	\$ 1,208,865	\$ 892,200
Claims and policy benefits	133,231	123,743
Acquisition costs	188,490	201,137
Operating expenses	260,527	229,108
Exchange (gains) losses	9,514	(21,083)
Interest expense	54,147	49,070
Amortization of intangible assets	465	465
Total expenses	\$ 1,855,239	\$ 1,474,640
Income (loss) before income tax and income (loss) from operating affiliates	\$ (240,381)	\$ 162,109
Provision (benefit) for income tax	(32,797)	29,836
Income (loss) from operating affiliates	13,636	11,606
Net income (loss)	\$ (193,948)	\$ 143,879
Non-controlling interests	(33,336)	1
Net income (loss) attributable to XL Group plc	\$ (227,284)	\$ 143,880
Preference share dividends		(32,500)
Gain on redemption of Series C preference ordinary shares		16,616
Net income (loss) attributable to ordinary shareholders	\$ (227,284)	\$ 127,996
Weighted average ordinary shares and ordinary share equivalents outstanding basic	311,478	342,148
Weighted average ordinary shares and ordinary share equivalents outstanding diluted	311,478	342,760
Earnings per ordinary share and ordinary share equivalent basic	\$ (0.73)	\$ 0.37

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Earnings per ordinary share and ordinary share equivalent - diluted	\$	(0.73)	\$	0.37
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See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	(Unaudited) Three Months Ended March 31,	
	2011	2010
<i>(U.S. dollars in thousands)</i>		
Net income (loss) attributable to XL Group plc	\$ (227,284)	\$ 143,880
Change in net unrealized gains (losses) on investments, net of tax	13,379	542,109
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	24,235	13,915
Change in OTTI losses recognized in other comprehensive income, net of tax	25,307	(16,458)
Change in underfunded pension liability	(344)	3,482
Change in value of cash flow hedge	110	110
Change in net unrealized gain (loss) on future policy benefit reserves		(2,752)
Foreign currency translation adjustments, net	11,616	(32,485)
Comprehensive income (loss)	\$ (152,981)	\$ 651,801

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	(Unaudited) Three Months Ended March 31,	
	2011	2010
<i>(U.S. dollars in thousands)</i>		
Non-controlling Interest in Equity of Consolidated Subsidiaries:		
Balance beginning of year	\$ 1,002,296	\$ 2,305
Non-controlling interests	4	\$ (1)
Non-controlling interest share in change in accumulated other comprehensive (income) loss	(2)	1
Purchase of Series E preference ordinary shares	(500)	
Balance end of period	\$ 1,001,798	\$ 2,305
Series E Preference Ordinary Shares:		
Balance beginning of year	\$	\$ 10
Balance end of period	\$	\$ 10
Ordinary Shares:		
Balance beginning of year	\$ 3,165	\$ 3,421
Issuance of ordinary shares	2	
Exercise of stock options		1
Buybacks of ordinary shares	(73)	(1)
Balance end of period	\$ 3,094	\$ 3,421
Additional Paid in Capital:		
Balance beginning of year	\$ 8,993,016	\$ 10,474,688
Issuance of ordinary shares	8	8
Buybacks of ordinary shares	(166,429)	(1,840)
Exercise of stock options, net of tax		104
Share based compensation expense	10,169	9,269
Balance end of period	\$ 8,836,764	\$ 10,482,229
Accumulated Other Comprehensive Income (Loss):		
Balance beginning of year	\$ 100,795	\$ (1,142,467)
Change in net unrealized gains (losses) on investments, net of tax	13,379	542,109
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	24,235	13,915
Change in OTTI losses recognized in other comprehensive income, net of tax	25,307	(16,458)
Change in underfunded pension liability	(344)	3,482
Change in value of cash flow hedge	110	110
Foreign currency translation adjustments	11,616	(32,485)
Change in net unrealized gain (loss) on future policy benefit reserves		(2,752)
Balance end of period	\$ 175,098	\$ (634,546)
Retained Earnings (Deficit):		
Balance beginning of year	\$ 513,777	\$ 94,460
Net income attributable to XL Group plc	(227,284)	143,880
Dividends on Series E preference ordinary shares		(32,500)

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Dividends on ordinary shares	(34,251)	(34,312)
Gain on redemption of Series C preference ordinary shares		16,616
	<u> </u>	<u> </u>
Balance end of period	\$ 252,242	\$ 188,144
	<u> </u>	<u> </u>
Total Shareholders Equity	\$ 10,268,996	\$ 10,041,563
	<u> </u>	<u> </u>

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited Three Months Ended March 31,	
	2011	2010
<i>(U.S. dollars in thousands)</i>		
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$ (193,948)	\$ 1,222,182
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Net realized losses on sales investments	66,437	(3,567)
Net realized and unrealized losses on derivative instruments	(3,567)	19,861
Amortization of (discounts) on fixed maturities	19,861	(40,786)
(Income) loss from investment and operating affiliates	(40,786)	8,829
Amortization of deferred compensation	8,829	249
Accretion of convertible debt	249	16,887
Accretion of deposit liabilities	16,887	29,810
Unpaid losses and loss expenses	29,810	11,969
Depreciation expense	11,969	(24,989)
Future policy benefit reserves	(24,989)	524,331
Unearned premiums	524,331	(476,200)
Premiums receivable	(476,200)	112,365
Unpaid losses and loss expenses recoverable	112,365	(84,247)
Ceded unearned premiums	(84,247)	(5,617)
Reinsurance balances receivable	(5,617)	(62,634)
Deferred acquisition costs	(62,634)	220,048
Reinsurance balances payable	220,048	(42,956)
Deferred tax asset	(42,956)	53,240
Derivatives	53,240	(3,841)
Other assets	(3,841)	(103,843)
Other liabilities	(103,843)	41,937
Other	41,937	
Total adjustments	\$ 257,283	\$ 257,283
Net cash provided by (used in) operating activities	\$ 63,335	\$ 257,283
Cash flows provided by (used in) investing activities:		
Proceeds from sale of fixed maturities and short-term investments	\$ 1,122,182	\$ 1,222,182
Proceeds from redemption of fixed maturities and short-term investments	689,130	689,130
Proceeds from sale of equity securities	70,349	70,349
Purchases of fixed maturities and short-term investments	(1,188,395)	(1,188,395)
Purchases of equity securities	(248,446)	(248,446)
Net dispositions of investment affiliates	51,170	51,170
Other investments, net	4,103	4,103
Net cash provided by (used in) investing activities	\$ 500,093	\$ (500,093)
Cash flows (used in) financing activities:		
Buybacks of ordinary shares	\$ (166,502)	\$ (166,502)
Redemption of Series C preference ordinary shares	(34,021)	(34,021)
Dividends paid on ordinary shares	(34,021)	(34,021)
Dividends paid on preference ordinary shares	(2,287)	(2,287)
Distributions to non-controlling interests	(2,287)	(2,287)
Deposit liabilities	(26,648)	(26,648)

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Net cash (used in) financing activities	\$ (229,458)	\$ (229,458)
Effects of exchange rate changes on foreign currency cash	28,967	28,967
Increase (decrease) in cash and cash equivalents	362,937	362,937
Cash and cash equivalents □ beginning of period	3,022,868	3,022,868
Cash and cash equivalents □ end of period	\$ 3,385,805	\$ 3,385,805

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

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

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

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

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

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

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

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

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

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

In June 2009, the FASB issued final authoritative guidance over accounting for transfers of financial assets that removed the concept of a qualifying special-purpose entity from existing accounting guidance over transfers of financial assets and also removes the exception from applying guidance surrounding consolidation of variable interest entities to qualifying special-purpose entities. This new guidance was applied by the Company from January 1, 2010; however, it did not have an impact on the Company's financial condition or results of operations.

In June 2009, the FASB issued final authoritative accounting guidance in an effort to improve financial reporting by enterprises involved with variable interest entities. This guidance retains the scope of the previous standard covering variable interest entities except, as noted above, with the addition of entities previously considered qualifying special-purpose entities. The new guidance requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity under revised guidance that are more qualitative than under previous guidance and amends previous guidance to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. Before this update, previous guidance required reconsideration of whether an enterprise is the primary beneficiary of a variable interest entity only when specific events occurred. The new guidance also amends previous guidance to require enhanced disclosures that provide users of financial statements with more transparent information about an enterprise's involvement with a variable interest entity. The enhanced disclosures are required for any enterprise that holds a variable interest in a variable interest entity. The content of the enhanced disclosures required by this new guidance is generally consistent with that required by the previous standards. The Company applied this new guidance from January 1, 2010; however, it did not have an impact on the Company's financial condition and results of operations. See Note 10, Variable Interest Entities, for the disclosures required by this guidance.

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

In July 2010, the FASB amended the general accounting principles for receivables as they relate to the disclosures about the credit quality of financing receivables and the allowance for credit losses. This amendment requires additional disclosures that provide a greater level of disaggregated information about the credit quality of financing receivables and the allowance for credit losses. It also requires the disclosure of credit quality indicators, past due information, and modifications of financing receivables. The new disclosures are required for interim and annual periods ending after December 15, 2010, although the disclosures of reporting period activity (i.e., allowance roll-forward and modification disclosures) are required for interim and annual periods beginning after December 15, 2010. This standard affects disclosures only and, accordingly, did not have an impact on the Company's financial condition or results of operations. During the fourth quarter of 2010, the Company recorded a provision of \$9.9 million related to two structured loan investments. This provision remains unchanged at March 31, 2011. The Company holds investments in five separate structured loans with aggregate net carrying values of \$42.0 million and \$42.3 million at March 31, 2011 and December 31, 2010, respectively. In addition, the Company had gross reinsurance balances receivable and reinsurance recoverables on unpaid losses and loss expense of \$3.9 billion at each of March 31, 2011 and December 31, 2010, against which an allowance of \$120.2 million and \$121.9 million was recorded at March 31, 2011 and December 31, 2010, respectively. There were no charge offs recorded during the current period.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Significant Accounting Policies (Continued)

(a) Recent Accounting Pronouncements (Continued)

In October 2010, the FASB issued authoritative guidance to address disparities in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments in the updated guidance specify that incremental direct costs of contract acquisition and certain costs related directly to the acquisition activities (i.e., underwriting, policy issuance and processing sales force contract selling, etc.) incurred in the acquisition of new or renewal contracts should be capitalized in accordance with the amendments in the updated guidance. Costs directly related to those activities include only the portion of an employee's total compensation (excluding any compensation that is capitalized as incremental direct costs of contract acquisition) and payroll-related fringe benefits related directly to time spent performing those activities for actual acquired contracts, and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. Administrative costs, rent, depreciation, occupancy, equipment and all other general overhead costs are considered indirect costs and should be charged to expense as incurred. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The amendments in this guidance should be applied prospectively upon adoption. Retrospective application is also permitted. This guidance is not expected to have an impact on the Company's financial condition or results of operations.

3. Fair Value Measurements

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at March 31, 2011 and December 31, 2010 by level within the fair value hierarchy (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, 2010):

March 31, 2011 <i>(U.S. dollars in thousands)</i> <i>(Unaudited)</i>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at March 31, 2011
Assets					
U.S. Government and Government-Related/Supported Corporate (1)	\$	\$ 2,095,080	\$	\$	\$ 2,095,080
Residential mortgage-backed securities Agency		9,993,235	34,866		10,028,101
Residential mortgage-backed securities Non-Agency		5,025,609	32,987		5,058,596
Commercial mortgage-backed securities Collateralized debt obligations		871,215	3,335		874,550
Other asset-backed securities		1,131,567	1,757		1,133,324
U.S. States and political subdivisions of the States		13,558	742,284		755,842
Non-U.S. Sovereign Government, Supranational and Government-Related		939,937	12,371		952,308
		1,357,215			1,357,215
		2,615,599			2,615,599
Total fixed maturities, at fair value	\$	\$ 24,043,015	\$ 827,600	\$	\$ 24,870,615
Equity securities, at fair value	245,248	25,744			270,992
Short-term investments, at fair value (1)(2)		2,376,497	286		2,376,783
Total investments available for sale	\$ 245,248	\$ 26,445,256	\$ 827,886	\$	\$ 27,518,390
Cash equivalents (3)	1,795,331	425,325			2,220,656
Other investments (4)		506,507	144,834		651,341
Other assets (5)(6)		84,141	7,958	(22,741)	69,358
Total assets accounted for at fair value	\$ 2,040,579	\$ 27,461,229	\$ 980,678	\$ (22,741)	\$ 30,459,745
Liabilities					
Financial instruments sold, but not yet purchased (7)	\$	\$ 23,324	\$	\$	\$ 23,324
Other liabilities (5)(6)		102,307	44,768	(2,977)	144,098
Total liabilities accounted for at fair value	\$	\$ 125,631	\$ 44,768	\$ (2,977)	\$ 167,422

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

December 31, 2010 <i>(U.S. dollars in thousands)</i>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at December 31, 2010
Assets					
U.S. Government and Government-Related/Supported Corporate (1)	\$	\$ 2,127,491	\$	\$	\$ 2,127,491
Residential mortgage-backed securities Agency		10,325,725	35,158		10,360,883
Residential mortgage-backed securities Non-Agency		5,134,491	30,255		5,164,746
Commercial mortgage-backed securities		1,016,124	4,964		1,021,088
Collateralized debt obligations		1,170,884	1,623		1,172,507
Other asset-backed securities		12,566	721,097		733,663
U.S. States and political subdivisions of the States		924,181	24,650		948,831
Non-U.S. Sovereign Government, Supranational and Government-Related		1,351,677			1,351,677
		2,659,626	3,667		2,663,293
Total fixed maturities, at fair value	\$	\$ 24,722,765	\$ 821,414	\$	\$ 25,544,179
Equity securities, at fair value	71,284	13,483			84,767
Short-term investments, at fair value (1)(2)		2,046,424	2,183		2,048,607
Total investments available for sale	\$ 71,284	\$ 26,782,672	\$ 823,597	\$	\$ 27,677,553
Cash equivalents (3)	1,358,619	540,646			1,899,265
Other investments (4)		490,320	133,717		624,037
Other assets (5)(6)		108,056	7,882	(20,152)	95,786
Total assets accounted for at fair value	\$ 1,429,903	\$ 27,921,694	\$ 965,196	\$ (20,152)	\$ 30,296,641
Liabilities					
Financial instruments sold, but not yet purchased (7)	\$ 256	\$ 21,270	\$	\$	\$ 21,526
Other liabilities (5)(6)		13,591	47,077	2,843	63,511
Total liabilities accounted for at fair value	\$ 256	\$ 34,861	\$ 47,077	\$ 2,843	\$ 85,037

Notes:

- (1) Included within Corporate are certain medium term notes supported primarily by pools of European credit with varying degrees of leverage. The notes had a fair value of \$485.0 million and \$454.8 million and an amortized cost of \$511.7 million and \$504.6 million at March 31, 2011 and December 31, 2010, respectively. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

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- (2) Short-term investments consist primarily of Corporate, U.S. Government and Government-Related/Supported securities and Non-U.S. Sovereign Government, Supranational and Government-Related securities.
- (3) 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.
- (4) The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments are carried at amortized cost that totaled \$326.4 million at March 31, 2011 and \$327.7 million at December 31, 2010.
- (5) Other assets and other liabilities include derivative instruments.
- (6) The derivative balances included in each category above are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under a netting agreement. In addition, the Company held net cash collateral related to derivative positions of approximately \$19.8 million and \$23.0 million at March 31, 2011 and December 31, 2010, respectively. This balance is included within cash and cash equivalents and the corresponding liability to return the collateral has been offset against the derivative positions within the balance sheet as appropriate under the netting agreement. The fair value of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.
- (7) Financial instruments sold, but not yet purchased represent short sales and are included within Net payable for investments purchased on the balance sheet.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The table reflects gains and losses for the three month periods ended March 31, 2011 and 2010 for all financial assets and liabilities categorized as Level 3 at March 31, 2011 and 2010, respectively. The tables do not include gains or losses that were reported in Level 3 in prior periods for assets that were transferred out of Level 3 prior to March 31, 2011 and 2010. Gains and losses for assets and liabilities classified within Level 3 in the table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following table does 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 the values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker 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, and other valuations sourced from brokers which are considered Level 3.

There were no transfers between Level 1 and Level 2 during the three month periods ended March 31, 2011 and 2010.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Three Months Ended March 31, 2011				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
Balance, beginning of period	\$ 35,158	\$ 30,255	\$ 4,964	\$ 1,623	\$ 721,097
Realized gains (losses)				(889)	(652)
Movement in unrealized gains (losses)	55	38	6	1,040	26,088
Purchases and issuances	10,629	11,460			
Sales and settlements	(809)	(1,269)	(301)	(17)	(4,249)
Transfers into Level 3	4,397	3,944			
Transfers out of Level 3	(14,545)	(11,441)	(1,334)		
Fixed maturities to short-term investments classification change	(19)				
Balance, end of period	\$ 34,866	\$ 32,987	\$ 3,335	\$ 1,757	\$ 742,284
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 51	\$ 38	\$ 6	\$ 151	\$ 25,436

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Three Months Ended March 31, 2011 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government Related	Short-term Investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	\$ 24,650	\$ 3,667	\$ 2,183	\$ 133,717	\$ (39,195)
Realized gains (losses)	(452)				
Movement in unrealized gains (losses)	2,818		(51)	9,771	2,449
Purchases and issuances				1,864	
Sales and settlements	(9,650)		(1,327)	(518)	(64)
Transfers into Level 3					
Transfers out of Level 3	(4,995)	(3,667)	(538)		
Fixed maturities to short-term investments classification change			19		
Balance, end of period	\$ 12,371	\$	\$ 286	\$ 144,834	\$ (36,810)
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 1,912	\$	\$ (43)	\$ 8,707	\$ 2,449

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Three Months Ended March 31, 2010				
	Corporate	Residential mortgage-backed securities Agency	Residential mortgage-backed securities Non Agency	Commercial mortgage-backed securities	Collateralized debt obligations
Balance, beginning of period	\$ 10,311	\$ 7,894	\$ 42,190	\$ 2,755	\$ 190,663
Realized gains (losses)	(4,319)		(817)	(457)	(4,917)
Movement in unrealized gains (losses)	26		4,392	1,337	31,384
Purchases and issuances					
Sales and settlements	(927)		(802)	(524)	(1,884)
Transfers into Level 3	8,158		117	38,544	496,503
Transfers out of Level 3	(2,600)	(7,894)	(15,080)		
Fixed maturities to short-term investments classification change	(1,156)				
Balance, end of period	\$ 9,493	\$	\$ 30,000	\$ 41,655	\$ 711,749
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 165	\$	\$ 4,258	\$ 888	\$ 30,956

(U.S. dollars in thousands) (Unaudited)	Level 3 Assets and Liabilities Three Months Ended March 31, 2010 (Continued)				
	Other asset backed securities	Non-U.S. Sovereign Government and Supranationals and Government Related	Short-term Investments	Other investments	Derivative Contracts - Net
Balance, beginning of period	\$ 38,179	\$ 3,217	\$ 6,486	\$ 75,584	\$ 100,515
Realized gains (losses)	(6,351)		(2,848)		
Movement in unrealized gains (losses)	4,545	11	2,448	3,985	(1,390)
Purchases and issuances	23,976			4,746	5,462
Sales and settlements	(1,719)		(2,246)	(1,227)	(113)
Transfers into Level 3	204	14	1,570		
Transfers out of Level 3	(6,752)				
Fixed maturities to short-term investments classification change			1,156		
Balance, end of period	\$ 52,082	\$ 3,242	\$ 6,566	\$ 83,088	\$ 104,474
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ (1,820)	\$ 11	\$ 2,373	\$ 3,985	\$ (1,390)

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Fixed maturities and short-term investments

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

Other investments

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

Derivative instruments

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

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Fair Value Measurements (Continued)

Level 3 Gains and Losses (continued)

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

Financial Instruments Not Carried at Fair Value

Authoritative guidance over disclosures about fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, 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:

	(Unaudited) March 31, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>(U.S. dollars in thousands)</i>				
Fixed maturities, held to maturity	\$ 2,828,108	\$ 2,773,590	\$ 2,728,335	\$ 2,742,626
Other investments structured transactions.	\$ 326,354	\$ 312,210	\$ 327,686	\$ 317,524
Financial Assets	\$ 3,154,462	\$ 3,085,800	\$ 3,056,021	\$ 3,060,150
Deposit liabilities	\$ 1,670,609	\$ 1,714,429	\$ 1,684,606	\$ 1,737,107
Notes payable and debt	2,462,917	2,694,747	2,464,410	2,627,897
Financial Liabilities	\$ 4,133,526	\$ 4,409,176	\$ 4,149,016	\$ 4,365,004
Non-controlling interest - Redeemable series C preference ordinary shares	\$ 71,150	\$ 59,766	\$ 71,900	\$ 61,115

The Company historically participated in structured transactions which 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 determines the estimated fair value of the deposit liabilities by assuming a discount rate equal to the appropriate U.S. Treasury rate plus 134.0 basis points and the appropriate U.S. Treasury Rate plus 142.3 basis points at March 31, 2011 and December 31, 2010, respectively. The discount rate incorporates the Company's own credit risk into the determination of estimated fair value.

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

The fair value of the Company's redeemable Series C preference ordinary shares outstanding is determined based on indicative quotes provided by brokers.

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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.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information

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

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

Quarter ended March 31, 2011:

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

	<u>Insurance</u>	<u>Reinsurance</u>	<u>Total P&C</u>	<u>Life Operations</u>	<u>Corporate</u>	<u>Total</u>
Gross premiums written	\$ 1,222,349	\$ 876,771	\$ 2,099,120	\$ 97,659	\$	\$ 2,196,779
Net premiums written	918,990	795,292	1,714,282	89,672		1,803,954
Net premiums earned	875,920	395,776	1,271,696	89,687		1,361,383
Net losses and loss expenses	(788,513)	(420,352)	(1,208,865)	(133,231)		(1,342,096)
Acquisition costs	(107,644)	(73,526)	(181,170)	(7,320)		(188,490)
Operating expenses (1)	(164,095)	(45,630)	(209,725)	(2,166)		(211,891)
Underwriting profit (loss)	\$ (184,332)	\$ (143,732)	\$ (328,064)	\$ (53,030)	\$	\$ (381,094)
Net investment income			183,565	76,976		260,541
Net results from structured products (2)	3,260	4,214	7,474			7,474
Net fee income and other (3)	(5,912)	1,394	(4,518)	41		(4,477)
Net realized gains (losses) on investments			(26,886)	(39,551)		(66,437)
Contribution from P&C, Life Operations and Corporate			<u>\$ (168,429)</u>	<u>\$ (15,564)</u>	<u>\$</u>	<u>\$ (183,993)</u>
Corporate & other:						
Net realized & unrealized gains (losses) on derivative instruments					\$ 3,567	\$ 3,567
Net income (loss) from investment fund affiliates and operating affiliates (4)					40,786	40,786
Exchange gains (losses)					(9,514)	(9,514)
Corporate operating expenses					(35,227)	(35,227)
Interest expense (5)					(41,899)	(41,899)
Non-controlling interests					(33,336)	(33,336)
Income taxes & other					32,332	32,332
Net income attributable to XL Group plc						<u>\$ (227,284)</u>

Ratios P&C operations: (6)

Loss and loss expense ratio	90.0%	106.2%	95.1%
Underwriting expense ratio	31.0%	30.1%	30.7%

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Combined ratio	121.0%	136.3%	125.8%
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Notes:

- (1) Operating expenses exclude Corporate operating expenses, shown separately.
- (2) The net results from P&C structured products include net investment income and interest expense of \$19.7 million and \$12.2 million.
- (3) Net fee income and other includes operating expenses from the Company's loss prevention consulting services business and expenses related to the cost of an endorsement facility with National Indemnity Company.
- (4) The Company records the income related to the alternative funds and to the private investment 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 and Corporate.
- (6) Ratios are based on net premiums earned from P&C operations.

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Segment Information (Continued)

Quarter ended March 31, 2010:

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

(Unaudited)

	Insurance	Reinsurance	Total P&C	Life Operations	Corporate	Total
Gross premiums written	\$ 1,131,890	\$ 790,423	\$ 1,922,313	\$ 112,901	\$	\$ 2,035,214
Net premiums written	901,264	695,261	1,596,525	104,666		1,701,191
Net premiums earned	897,011	366,590	1,263,601	104,884		1,368,485
Net losses and loss expenses	(648,319)	(243,881)	(892,200)	(123,743)		(1,015,943)
Acquisition costs	(110,142)	(72,605)	(182,747)	(18,390)		(201,137)
Operating expenses (1)	(153,236)	(42,028)	(195,264)	(3,008)		(198,272)
Underwriting profit (loss)	\$ (14,686)	\$ 8,076	\$ (6,610)	\$ (40,257)	\$	\$ (46,867)
Net investment income			203,914	80,344		284,258
Net results from structured products (2)	5,639	2,476	8,115		3,653	11,768
Net fee income and other (3)	(3,786)	319	(3,467)	40		(3,427)
Net realized gains (losses) on investments			(28,577)	(4,413)	(3,186)	(36,176)
Contribution from P&C, Life Operations and Corporate			\$ 173,375	\$ 35,714	\$ 467	\$ 209,556
Corporate & other:						
Net realized & unrealized gains (losses) on derivative instruments					\$ (20,480)	\$ (20,480)
Net income (loss) from investment fund affiliates and operating affiliates (4)					19,784	19,784
Exchange gains (losses)					21,083	21,083
Corporate operating expenses					(18,863)	(18,863)
Interest expense (5)					(36,900)	(36,900)
Non-controlling interests					1	1
Income taxes & other					(30,301)	(30,301)
Net income attributable to XL Group plc						\$ 143,880
Ratios P&C operations: (6)						
Loss and loss expense ratio	72.3%	66.5%	70.6%			
Underwriting expense ratio	29.3%	31.3%	29.9%			