

XL GROUP PLC  
Form 10-Q  
May 06, 2014

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, 2014

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)

XL House, 8 St. Stephen's Green, Dublin 2, Ireland  
(Address of principal executive offices and zip code)

+353 (1) 400-5500

(Registrant's telephone number, including area code)

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

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

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

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

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

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

As of May 2, 2014, there were 271,499,156 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

XL GROUP PLC  
INDEX TO FORM 10-Q

Page No.

<u>PART I—FINANCIAL INFORMATION</u>		
<u>Item 1.</u>	<u>Financial Statements:</u>	
	Unaudited Consolidated Balance Sheets at March 31, 2014 and December 31, 2013	<u>1</u>
	Unaudited Consolidated Statements of Income for the Three Months Ended March 31, 2014 and 2013	<u>2</u>
	Unaudited Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2014 and 2013	<u>3</u>
	Unaudited Consolidated Statements of Shareholders' Equity for the Three Months Ended March 31, 2014 and 2013	<u>4</u>
	Unaudited Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2014 and 2013	<u>5</u>
	<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>34</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>67</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>74</u>
 <u>PART II—OTHER INFORMATION</u>		
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>75</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>75</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>75</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>76</u>
	<u>Signatures</u>	<u>77</u>

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## XL GROUP PLC

## UNAUDITED CONSOLIDATED BALANCE SHEETS

(U.S. dollars in thousands, except share data)	March 31, 2014	December 31, 2013
<b>ASSETS</b>		
Investments:		
Fixed maturities, at fair value (amortized cost: 2014, \$26,485,164; 2013, \$27,111,874)	\$27,139,824	\$27,500,136
Equity securities, at fair value (cost: 2014, \$907,952; 2013, \$903,201)	1,055,393	1,040,237
Short-term investments, at fair value (amortized cost: 2014, \$382,509; 2013, \$455,470)	382,113	456,288
Total investments available for sale	\$28,577,330	\$28,996,661
Fixed maturities, held to maturity at amortized cost (fair value: 2014, \$3,209,175; 2013, \$3,131,235)	2,854,487	2,858,695
Investments in affiliates	1,401,731	1,370,943
Other investments	1,218,223	1,164,630
Total investments	\$34,051,771	\$34,390,929
Cash and cash equivalents	2,476,047	1,800,832
Accrued investment income	322,596	346,809
Deferred acquisition costs	728,830	670,659
Ceded unearned premiums	900,193	788,871
Premiums receivable	3,209,214	2,612,602
Reinsurance balances receivable	179,615	118,885
Unpaid losses and loss expenses recoverable	3,412,195	3,435,230
Receivable from investments sold	119,980	144,765
Goodwill and other intangible assets	455,700	411,611
Deferred tax asset	215,286	237,884
Other assets	687,460	693,810
Total assets	\$46,758,887	\$45,652,887
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Unpaid losses and loss expenses	\$20,425,217	\$20,481,065
Deposit liabilities	1,497,599	1,509,243
Future policy benefit reserves	4,811,357	4,803,816
Unearned premiums	4,473,478	3,846,526
Notes payable and debt	2,262,824	2,263,203
Reinsurance balances payable	573,673	302,399
Payable for investments purchased	138,457	60,162
Deferred tax liability	93,718	86,330
Other liabilities	878,590	950,845
Total liabilities	\$35,154,913	\$34,303,589
Commitments and Contingencies		
Shareholders' Equity:		
Ordinary shares, 999,990,000 authorized, par value \$0.01; issued and outstanding (2014, 273,554,157; 2013, 278,253,308)	\$2,736	\$2,783

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Additional paid in capital	7,828,668	7,994,100
Accumulated other comprehensive income	946,661	736,657
Retained earnings	1,466,897	1,264,093
Shareholders' equity attributable to XL Group plc	\$10,244,962	\$9,997,633
Non-controlling interest in equity of consolidated subsidiaries	1,359,012	1,351,665
Total shareholders' equity	\$11,603,974	\$11,349,298
Total liabilities and shareholders' equity	\$46,758,887	\$45,652,887
See accompanying Notes to Unaudited Consolidated Financial Statements		

1

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XL GROUP PLC  
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended March 31,	
(U.S. dollars in thousands, except per share data)	2014	2013
Revenues:		
Net premiums earned	\$1,488,839	\$1,529,691
Net investment income	233,189	246,468
Realized investment gains (losses):		
Net realized gains (losses) on investments sold	22,956	41,147
Other-than-temporary impairments on investments	(2,276	) (3,727
Other-than-temporary impairments on investments transferred to (from) other comprehensive income	(1,451	) (911
Total net realized gains (losses) on investments	\$19,229	\$36,509
Net realized and unrealized gains (losses) on derivative instruments	1,810	7,885
Income (loss) from investment fund affiliates	33,303	32,221
Fee income and other	11,454	9,632
Total revenues	\$1,787,824	\$1,862,406
Expenses:		
Net losses and loss expenses incurred	\$831,505	\$843,084
Claims and policy benefits	113,587	110,953
Acquisition costs	199,414	220,259
Operating expenses	310,424	283,832
Exchange (gains) losses	10,441	(33,435
Interest expense	42,941	38,700
Total expenses	\$1,508,312	\$1,463,393
Income (loss) before income tax and income (loss) from operating affiliates	\$279,512	\$399,013
Income (loss) from operating affiliates	46,285	30,998
Provision (benefit) for income tax	34,321	43,479
Net income (loss)	\$291,476	\$386,532
Non-controlling interests	35,759	35,742
Net income (loss) attributable to ordinary shareholders	\$255,717	\$350,790
Weighted average ordinary shares and ordinary share equivalents outstanding, in thousands – basic	276,337	295,000
Weighted average ordinary shares and ordinary share equivalents outstanding, in thousands – diluted	280,458	299,469
Earnings (loss) per ordinary share and ordinary share equivalent – basic	\$0.93	\$1.19
Earnings (loss) per ordinary share and ordinary share equivalent – diluted	\$0.91	\$1.17
See accompanying Notes to Unaudited Consolidated Financial Statements		

## XL GROUP PLC

## UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(U.S. dollars in thousands)	Three Months Ended	
	March 31,	
	2014	2013
Net income (loss) attributable to ordinary shareholders	\$255,717	\$350,790
Change in net unrealized gains (losses) on investments, net of tax	207,387	(112,222 )
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	3,123	(4,434 )
Change in OTTI losses recognized in other comprehensive income, net of tax	3,296	5,182
Change in underfunded pension liability, net of tax	(32 )	) 385
Change in value of cash flow hedge	110	110
Foreign currency translation adjustments, net of tax	(3,880 )	) (3,919 )
Comprehensive income (loss)	\$465,721	\$235,892
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC  
UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(U.S. dollars in thousands)	Three Months Ended March 31,	
	2014	2013
<b>Ordinary Shares:</b>		
Balance - beginning of year	\$2,783	\$2,987
Issuance of ordinary shares	10	8
Buybacks of ordinary shares	(58	) (80
Exercise of stock options	1	3
Balance - end of period	\$2,736	\$2,918
<b>Additional Paid in Capital:</b>		
Balance - beginning of year	\$7,994,100	\$8,584,752
Issuance of ordinary shares	7	7
Buybacks of ordinary shares	(168,144	) (220,572
Exercise of stock options	1,309	4,313
Share-based compensation expense	1,396	3,026
Balance - end of period	\$7,828,668	\$8,371,526
<b>Accumulated Other Comprehensive Income (Loss):</b>		
Balance - beginning of year	\$736,657	\$1,520,020
Change in net unrealized gains (losses) on investments, net of tax	207,387	(112,222
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	3,123	(4,434
Change in OTTI losses recognized in other comprehensive income, net of tax	3,296	5,182
Change in underfunded pension liability, net of tax	(32	) 385
Change in value of cash flow hedge	110	110
Foreign currency translation adjustments, net of tax	(3,880	) (3,919
Balance - end of period	\$946,661	\$1,405,122
<b>Retained Earnings (Deficit):</b>		
Balance - beginning of year	\$1,264,093	\$402,318
Net income (loss) attributable to ordinary shareholders	255,717	350,790
Dividends on ordinary shares	(44,620	) (41,553
Buybacks of ordinary shares	(8,293	) (3,767
Balance - end of period	\$1,466,897	\$707,788
<b>Non-controlling Interest in Equity of Consolidated Subsidiaries:</b>		
Balance - beginning of year	\$1,351,665	\$1,346,325
Non-controlling interests - contribution	7,001	—
Non-controlling interests - distribution	—	(37
Non-controlling interests	346	82
Non-controlling interest share in change in accumulated other comprehensive income (loss)	—	(29
Non-controlling interests - deconsolidation	—	(1,841
Balance - end of period	\$1,359,012	\$1,344,500
<b>Total Shareholders' Equity</b>	<b>\$11,603,974</b>	<b>\$11,831,854</b>
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31,	
(U.S. dollars in thousands)	2014	2013
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$291,476	\$386,532
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Net realized (gains) losses on investments	(19,229)	(36,509)
Net realized and unrealized (gains) losses on derivative instruments	(1,810)	(7,885)
Amortization of premiums (discounts) on fixed maturities	39,488	37,783
(Income) loss from investment and operating affiliates	(31,999)	(63,219)
Share-based compensation	15,974	15,086
Depreciation	14,961	13,109
Accretion of deposit liabilities	10,477	12,564
Changes in:		
Unpaid losses and loss expenses	(72,058)	(117,861)
Future policy benefit reserves	(49,780)	(48,114)
Unearned premiums	621,009	636,875
Premiums receivable	(594,243)	(629,528)
Unpaid losses and loss expenses recoverable	28,747	2,973
Ceded unearned premiums	(110,310)	(65,191)
Reinsurance balances receivable	(60,224)	(41,234)
Deferred acquisition costs	(56,937)	(70,547)
Reinsurance balances payable	269,717	129,253
Deferred tax asset - net	(598)	(17,565)
Derivatives	(12,277)	52,675
Other assets	(25,731)	(24,197)
Other liabilities	(77,037)	(23,052)
Other	20,452	3,696
Total adjustments	\$(91,408)	\$(240,888)
Net cash provided by (used in) operating activities	\$200,068	\$145,644
Cash flows provided by (used in) investing activities:		
Proceeds from sale of fixed maturities and short-term investments	\$1,106,926	\$1,198,391
Proceeds from redemption of fixed maturities and short-term investments	1,056,358	1,174,101
Proceeds from sale of equity securities	76,382	37,446
Purchases of fixed maturities and short-term investments	(1,411,447)	(2,262,022)
Purchases of equity securities	(80,833)	(209,793)
Proceeds from sale of affiliates	145,174	45,979
Purchases of affiliates	(86,205)	(108,366)
Other, net	(106,075)	121,771
Net cash provided by (used in) investing activities	\$700,280	\$(2,493)
Cash flows provided by (used in) financing activities:		
Proceeds from issuance of ordinary shares and exercise of stock options	\$1,310	\$3,248
Buybacks of ordinary shares	(176,496)	(224,420)
Dividends paid on ordinary shares	(43,847)	(805)
Distributions to non-controlling interests	(3,008)	(3,257)
Contributions from non-controlling interests	7,001	—
Deposit liabilities	(17,270)	(38,704)



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Net cash provided by (used in) financing activities	\$(232,310 )	\$(263,938 )
Effects of exchange rate changes on foreign currency cash	7,177	(24,304 )
Increase (decrease) in cash and cash equivalents	\$675,215	\$(145,091 )
Cash and cash equivalents - beginning of period	1,800,832	2,618,378
Cash and cash equivalents - end of period	\$2,476,047	\$2,473,287
See accompanying Notes to Unaudited Consolidated Financial Statements		

5

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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, an Irish public limited company (“XL-Ireland”), and its consolidated subsidiaries.

These unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but do not include all disclosures required by GAAP. In the opinion of management, these unaudited financial statements reflect all adjustments considered necessary for a fair statement of financial position and results of operations at the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All inter-company accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates. For further information, see Item 8, Note 2(a), “Significant Accounting Policies – Basis of Preparation and Consolidation,” to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

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 July 2013, the FASB issued an accounting standards update concerning the presentation of unrecognized tax benefits. The objective of the guidance is to improve the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance seeks to reduce the diversity in practice by providing guidance on the presentation of unrecognized tax benefits to better reflect the manner in which an entity would settle, at the reporting date, any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The guidance was effective for annual and interim reporting periods beginning after December 15, 2013, with both early adoption and retrospective application permitted. This guidance did not have a significant impact on the Company’s financial condition, results of operations or cash flows.

In April 2014, the FASB issued an accounting standards update intended to improve financial reporting by tightening the key criteria evaluating whether disposal transactions meet the definition of discontinued operations. Under the standard, only those disposals - either by sale or otherwise - of components of an entity that have, or will have, a major effect on an entity’s operations and financial results would qualify for reporting as discontinued operations. Disposals that are considered to be routine in nature can no longer be reported as discontinued operations. However, the standard does relax one aspect of the current criteria - a disposal may now qualify for discontinued operations reporting even if the disposed component’s operations and cash flows are not eliminated from on-going operations of the disposing entity, or if post-disposal, the disposing entity still has significant continuing involvement in the component’s operations. The standard also establishes both additional disclosure requirements and expanded disclosures regarding on-going involvement an entity may have with a discontinued operation after its disposal. The guidance is effective prospectively for all public company disposals (or component reclassifications to held-for-sale) that occur within annual periods beginning on or after December 15, 2014. Early adoption is permitted, but only for disposals (or component reclassifications to held-for-sale) that have not been reported in financial statements issued or available for issuance prior to the effective date. The Company is currently evaluating the impact of this guidance.



XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Fair Value Measurements

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

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

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

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

For further information, see Item 8, Note 2(b), "Significant Accounting Policies - Fair Value Measurements," to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

XL GROUP PLC  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## (a) Fair Value Summary

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at March 31, 2014 and December 31, 2013 by level within the fair value hierarchy:

March 31, 2014 (U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at March 31, 2014
<b>Assets</b>					
U.S. Government and Government - Related/Supported	\$—	\$2,319,052	\$—	\$—	\$2,319,052
Corporate (1)	—	11,104,123	4,382	—	11,108,505
Residential mortgage-backed securities – Agency (“RMBS - Agency”)	—	3,213,555	8,928	—	3,222,483
Residential mortgage-backed securities – Non-Agency (“RMBS - Non-Agency”)	—	401,382	11	—	401,393
Commercial mortgage-backed securities (“CMBS”)	—	1,192,386	5,926	—	1,198,312
Collateralized debt obligations (“CDO”)	—	6,233	718,827	—	725,060
Other asset-backed securities (2)	—	1,185,639	10,673	—	1,196,312
U.S. States and political subdivisions of the States	—	1,902,451	—	—	1,902,451
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	—	5,066,256	—	—	5,066,256
Total fixed maturities, at fair value	\$—	\$26,391,077	\$748,747	\$—	\$27,139,824
Equity securities, at fair value (3)	549,454	505,939	—	—	1,055,393
Short-term investments, at fair value (1)(4)	—	382,113	—	—	382,113
Total investments available for sale	\$549,454	\$27,279,129	\$748,747	\$—	\$28,577,330
Cash equivalents (5)	1,270,563	485,486	—	—	1,756,049
Other investments (6)	—	813,757	116,418	—	930,175
Other assets (7)	—	8,858	—	—	8,858
Total assets accounted for at fair value	\$1,820,017	\$28,587,230	\$865,165	\$—	\$31,272,412
<b>Liabilities</b>					
Financial instruments sold, but not yet purchased (8)	\$—	\$30,896	\$—	\$—	\$30,896
Other liabilities (7)	—	28,871	32,496	—	61,367
Total liabilities accounted for at fair value	\$—	\$59,767	\$32,496	\$—	\$92,263

XL GROUP PLC  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013 (U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at December 31, 2013
<b>Assets</b>					
U.S. Government and Government - Related/Supported	\$—	\$2,501,851	\$—	\$—	\$2,501,851
Corporate (1)	—	11,094,257	31,573	—	11,125,830
RMBS – Agency	—	3,535,649	10,473	—	3,546,122
RMBS – Non-Agency	—	398,759	9	—	398,768
CMBS	—	1,234,262	12,533	—	1,246,795
CDO	—	7,060	710,253	—	717,313
Other asset-backed securities (2)	—	1,230,227	11,877	—	1,242,104
U.S. States and political subdivisions of the States	—	1,845,812	—	—	1,845,812
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	—	4,875,541	—	—	4,875,541
Total fixed maturities, at fair value	\$—	\$26,723,418	\$776,718	\$—	\$27,500,136
Equity securities, at fair value (3)	540,331	499,906	—	—	1,040,237
Short-term investments, at fair value (1)(4)	—	454,273	2,015	—	456,288
Total investments available for sale	\$540,331	\$27,677,597	\$778,733	\$—	\$28,996,661
Cash equivalents (5)	834,514	226,636	—	—	1,061,150
Other investments (6)	—	757,110	113,472	—	870,582
Other assets (7)	—	27,487	—	(1,342)	26,145
Total assets accounted for at fair value	\$1,374,845	\$28,688,830	\$892,205	\$(1,342)	\$30,954,538
<b>Liabilities</b>					
Financial instruments sold, but not yet purchased (8)	\$—	\$28,861	\$—	\$—	\$28,861
Other liabilities (7)	—	76,375	29,110	(1,342)	104,143
Total liabilities accounted for at fair value	\$—	\$105,236	\$29,110	\$(1,342)	\$133,004

Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes had a fair value of \$154.7 million and \$154.6 million and (1) an amortized cost of \$146.2 million and \$147.7 million at March 31, 2014 and December 31, 2013, respectively.

These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

The Company invests in covered bonds (“Covered Bonds”). Covered Bonds are senior secured debt instruments issued by financial institutions and backed by over-collateralized pools of public sector or mortgage loans. At (2) March 31, 2014 and December 31, 2013, Covered Bonds with a fair value of \$537.5 million and \$553.1 million, respectively, are included within Other asset-backed securities.

Included within Equity securities are investments in fixed income funds with a fair value of \$89.1 million and (3) \$87.4 million at March 31, 2014 and December 31, 2013, respectively.

- (4) Short-term investments consist primarily of Corporate securities and U.S. and Non-U.S. Government and Government-Related/ Supported securities.
- (5) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to recurring fair value measurement guidance. The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments, which totaled \$288.0 million at March 31, 2014 and \$294.0 million at December 31, 2013, are carried at amortized cost. For further information, see Item 8, Note 7, “Other Investments,” to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2013.
- (6) Other assets and other liabilities include derivative instruments. The derivative balances included in each category are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy. For further details regarding derivative fair values and associated collateral received or paid see Note 6, “Derivative Instruments,” to the Unaudited Consolidated Financial Statements.
- (7) Financial instruments sold, but not yet purchased, represent “short sales” and are included within “Payable for investments purchased” on the balance sheet.
- (8)

## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## (b) Level 3 Assets and Liabilities

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables present a reconciliation of the beginning and ending balances for the three months ended March 31, 2014 and 2013 for all financial assets and liabilities measured at fair value using significant unobservable inputs (Level 3) at March 31, 2014 and 2013, 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, 2014 and 2013. 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 unobservable inputs and other valuations sourced from brokers that are considered Level 3.

There were no significant transfers between Level 1 and Level 2 during the three months ended March 31, 2014 and 2013.

## Level 3 Assets and Liabilities -Three Months Ended March 31, 2014

(U.S. dollars in thousands)	Corporate	RMBS - Agency	RMBS - Non Agency	CMBS	CDO
Balance, beginning of period	\$31,573	\$ 10,473	\$9	\$12,533	\$710,253
Realized gains (losses)	120	(1	) —	2	1,581
Movement in unrealized gains (losses)	(2	) 1	2	(3	) 3,681
Purchases and issuances	1,434	—	—	—	27,814
Sales	—	—	—	—	(9,931
Settlements	(5,114	) (573	) —	(6,606	) (14,571
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	(23,629	) (972	) —	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—
Balance, end of period	\$4,382	\$ 8,928	\$11	\$5,926	\$718,827
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$ 148	\$ —	\$2	\$—	\$4,969

## Level 3 Assets and Liabilities -Three Months Ended March 31, 2014

(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	\$11,877	\$ —	\$2,015	\$113,472	\$(29,110



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Realized gains (losses)	(15	)	—	—	3,566	—
Movement in unrealized gains (losses)	62	—	—	(15	)	1,494 (3,386 )
Purchases and issuances	—	—	—	—	11,089	—
Sales	—	—	—	—	—	—
Settlements	(1,251	)	—	(2,000	)	(13,203 ) —
Transfers into Level 3	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—	—
Fixed maturities to short-term investments classification change	—	—	—	—	—	—
Balance, end of period	\$10,673	\$	—	\$—	\$116,418	\$(32,496 )
Movement in total gains (losses) above relating to instruments still held at the reporting date	\$46	\$	—	\$—	\$5,061	\$(3,386 )

## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Level 3 Assets and Liabilities -Three Months Ended March 31, 2013

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

## Level 3 Assets and Liabilities -Three Months Ended March 31, 2013

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

## (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 primarily to private investment funds and certain derivative positions as described below.

XL GROUP PLC  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(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, 2013.

(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 embedded within one reinsurance contract. The majority of inputs utilized in the valuations of these types of derivative contracts are considered Level 1 or Level 2; however, each valuation includes at least one Level 3 input that was significant to the valuation and, accordingly, the values are disclosed within Level 3.

(f) Financial Instruments Not Carried at Fair Value

Authoritative guidance over disclosures about the fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, net receivable from investments sold, other assets, net payable for investments purchased, other liabilities and other financial instruments not included below approximated their fair values. The following table includes financial instruments for which the carrying value differs from the estimated fair values at March 31, 2014 and December 31, 2013. All of these fair values estimates are considered Level 2 fair value measurements. The fair values for fixed maturities held to maturity are provided by third party pricing vendors and significant valuation inputs for all other items included were based upon market data obtained from sources independent of the Company, and are subject to the same control environment previously described.

(U.S. dollars in thousands)	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturities, held to maturity	\$2,854,487	\$3,209,175	\$2,858,695	\$3,131,235
Other investments - structured transactions	288,047	306,989	294,048	296,799
Financial Assets	\$3,142,534	\$3,516,164	\$3,152,743	\$3,428,034
Deposit liabilities	\$1,497,599	\$1,739,163	\$1,509,243	\$1,718,394
Notes payable and debt	2,262,824	2,483,414	2,263,203	2,429,412
Financial Liabilities	\$3,760,423	\$4,222,577	\$3,772,446	\$4,147,806

The Company historically participated in structured transactions. Remaining structured transactions include cash loans supporting project finance transactions, liquidity facility financing provided 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 54.8 basis points and 56.7 basis points at March 31, 2014 and December 31, 2013, respectively. The discount rate incorporates the Company's own credit risk into the determination of estimated fair value.

XL GROUP PLC  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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.

#### 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's performance is based on contribution to net income. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate to the individual segments investment assets used to support its Property and Casualty ("P&C") operations, except as noted below. 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. The following tables summarize the segment results for the three months ended March 31, 2014 and 2013:

##### Three Months Ended March 31, 2014

(U.S. dollars in thousands, except ratios)	Insurance	Reinsurance	Total P&C	Life Operations	Total
Gross premiums written	\$1,570,926	\$857,713	\$2,428,639	\$84,297	\$2,512,936
Net premiums written	1,127,367	792,173	1,919,540	76,311	1,995,851
Net premiums earned	992,440	420,088	1,412,528	76,311	1,488,839
Net losses and loss expenses	639,193	192,312	831,505	113,587	945,092
Acquisition costs	105,000	87,235	192,235	7,179	199,414
Operating expenses (1)	203,053	40,861	243,914	3,188	247,102
Underwriting profit (loss)	\$45,194	\$99,680	\$144,874	\$(47,643)	\$97,231
Net investment income			143,527	70,892	214,419
Net results from structured products (2)	4,890	3,063	7,953		7,953
Net fee income and other (3)	(1,212)	673	(539)	45	(494)
Net realized gains (losses) on investments			17,666	1,563	19,229
Contribution from P&C and Life Operations			\$313,481	\$24,857	\$338,338
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					1,810
Net income (loss) from investment fund affiliates and operating affiliates (4)					79,588
Exchange (gains) losses					10,441
Corporate operating expenses					51,338
Interest expense (5)					32,160
Non-controlling interests					35,759
Income tax expense					34,321
Net income (loss) attributable to ordinary shareholders					\$255,717
Ratios – P&C operations: (6)					

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Loss and loss expense ratio	64.4	% 45.8	% 58.9	%
Underwriting expense ratio	31.0	% 30.5	% 30.8	%
Combined ratio	95.4	% 76.3	% 89.7	%

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

(2) The net results from structured products include net investment income and interest expense of \$18.8 million and \$10.8 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

Three Months Ended March 31, 2013

(U.S. dollars in thousands, except ratios)	Insurance	Reinsurance	Total P&C	Life Operations	Total
Gross premiums written	\$1,497,787	\$907,129	\$2,404,916	\$72,970	\$2,477,886
Net premiums written	1,189,188	853,021	2,042,209	65,445	2,107,654
Net premiums earned	1,039,092	425,154	1,464,246	65,445	1,529,691
Net losses and loss expenses	650,517	192,567	843,084	110,953	954,037
Acquisition costs	130,622	85,534	216,156	4,103	220,259
Operating expenses (1)	183,997	40,421	224,418	2,595	227,013
Underwriting profit (loss)	\$73,956	\$106,632	\$180,588	\$(52,206)	\$128,382
Net investment income			157,039	71,688	228,727
Net results from structured products (2)	4,185	991	5,176		5,176
Net fee income and other (3)	(1,939)	632	(1,307)	1,043	(264)
Net realized gains (losses) on investments			45,578	(9,069)	36,509
Contribution from P&C and Life Operations			\$387,074	\$11,456	\$398,530
Corporate & other:					
Net realized & unrealized gains (losses) on derivative instruments					7,885
Net income (loss) from investment fund affiliates and operating affiliates (4)					63,219
Exchange (gains) losses					(33,435)
Corporate operating expenses					46,922
Interest expense (5)					26,136
Non-controlling interests					35,742
Income tax expense					43,479
Net income (loss) attributable to ordinary shareholders					\$350,790
Ratios – P&C operations: (6)					
Loss and loss expense ratio	62.6	% 45.3	% 57.6	%	
Underwriting expense ratio	30.3	% 29.6	% 30.1	%	
Combined ratio	92.9	% 74.9	% 87.7	%	

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

(2) The net results from structured products include net investment income and interest expense of \$17.7 million and \$12.6 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

The following tables summarize the Company's net premiums earned by line of business for the three months ended March 31, 2014 and 2013:

Three Months Ended March 31, 2014 (U.S. dollars in thousands)	Insurance	Reinsurance	Life Operations	Total
<b>P&amp;C Operations:</b>				
Professional	\$275,427	\$50,104	\$—	\$325,531
Casualty	344,004	76,721	—	420,725
Property catastrophe	—	108,437	—	108,437
Property	139,733	135,239	—	274,972
Marine, energy, aviation and satellite	—	23,514	—	23,514
Specialty	176,909	—	—	176,909
Other (1)	56,367	26,073	—	82,440
<b>Total P&amp;C Operations</b>	<b>\$992,440</b>	<b>\$420,088</b>	<b>\$—</b>	<b>\$1,412,528</b>
<b>Life Operations:</b>				
Annuity	\$—	\$—	\$31,797	\$31,797
Other Life	—	—	44,514	44,514
<b>Total Life Operations</b>	<b>\$—</b>	<b>\$—</b>	<b>\$76,311</b>	<b>\$76,311</b>
<b>Total</b>	<b>\$992,440</b>	<b>\$420,088</b>	<b>\$76,311</b>	<b>\$1,488,839</b>
Three Months Ended March 31, 2013 (U.S. dollars in thousands)	Insurance	Reinsurance	Life Operations	Total
<b>P&amp;C Operations:</b>				
Professional	\$350,838	\$45,436	\$—	\$396,274
Casualty	327,418	76,981	—	404,399
Property catastrophe	—	113,642	—	113,642
Property	124,450	141,269	—	265,719
Marine, energy, aviation and satellite	—	27,840	—	27,840
Specialty	182,965	—	—	182,965
Other (1)	53,421	19,986	—	73,407
<b>Total P&amp;C Operations</b>	<b>\$1,039,092</b>	<b>\$425,154</b>	<b>\$—</b>	<b>\$1,464,246</b>
<b>Life Operations:</b>				
Annuity	\$—	\$—	\$29,684	\$29,684
Other Life	—	—	35,761	35,761
<b>Total Life Operations</b>	<b>\$—</b>	<b>\$—</b>	<b>\$65,445</b>	<b>\$65,445</b>
<b>Total</b>	<b>\$1,039,092</b>	<b>\$425,154</b>	<b>\$65,445</b>	<b>\$1,529,691</b>

Other within the Insurance segment includes: excess and surplus, programs, surety, structured indemnity and (1) certain other discontinued lines. Other within the Reinsurance segment includes: whole account contracts, surety 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 March 31, 2014 and December 31, 2013, were as follows:

March 31, 2014 (U.S. dollars in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-credit Related OTTI (1)
Fixed maturities - AFS					
U.S. Government and Government-Related/Supported (2)	\$2,282,321	\$59,678	\$(22,947)	\$2,319,052	\$—
Corporate (3) (4)	10,697,760	490,229	(79,484)	11,108,505	(4,758)
RMBS – Agency	3,186,504	74,788	(38,809)	3,222,483	—
RMBS – Non-Agency	389,181	36,836	(24,624)	401,393	(71,999)
CMBS	1,172,597	36,282	(10,567)	1,198,312	(2,662)
CDO	758,469	3,649	(37,058)	725,060	(1,936)
Other asset-backed securities (5)	1,156,561	46,219	(6,468)	1,196,312	(2,117)
U.S. States and political subdivisions of the States	1,832,247	84,695	(14,491)	1,902,451	—
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	5,009,524	110,972	(54,240)	5,066,256	—
Total fixed maturities - AFS	\$26,485,164	\$943,348	\$(288,688)	\$27,139,824	\$(83,472)
Total short-term investments (2)	\$382,509	\$181	\$(577)	\$382,113	\$—
Total equity securities (6)	\$907,952	\$166,197	\$(18,756)	\$1,055,393	\$—
Total investments - AFS	\$27,775,625	\$1,109,726	\$(308,021)	\$28,577,330	\$(83,472)
Fixed maturities - HTM					
U.S. Government and Government-Related/Supported (2)	\$11,052	\$918	\$—	\$11,970	\$—
Corporate	1,376,931	135,909	(190)	1,512,650	—
RMBS – Non-Agency	67,037	6,743	—	73,780	—
CMBS	145,005	15,215	—	160,220	—
Other asset-backed securities (5)	106,514	9,437	—	115,951	—
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	1,147,948	186,656	—	1,334,604	—
Total investments - HTM	\$2,854,487	\$354,878	\$(190)	\$3,209,175	\$—

(1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

(2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$2,301.8 million and fair value of \$2,365.0 million and U.S. Agencies with an amortized cost of \$238.0 million and fair value of \$261.5 million.

(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 \$154.7 million and an amortized cost of \$146.2 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.

Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and (4) hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$279.8 million and an amortized cost of \$281.3 million.

Covered Bonds within Fixed maturities - AFS with an amortized cost of \$508.3 million and a fair value of \$537.5 million and Covered Bonds within Fixed maturities - HTM with an amortized cost of \$8.6 million and a fair value of \$8.9 million are included within Other asset-backed securities to align the Company's classification to market indices.

(5) Included within Total equity securities are investments in fixed income funds with a fair value of \$89.1 million and (6) an amortized cost of \$100.9 million.

## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013 (U.S. dollars in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-credit Related OTTI (1)
Fixed maturities - AFS					
U.S. Government and Government-Related/Supported (2)	\$2,484,193	\$51,701	\$(34,043)	\$2,501,851	\$—
Corporate (3) (4)	10,802,332	433,097	(109,599)	11,125,830	(4,758)
RMBS – Agency	3,540,101	68,098	(62,077)	3,546,122	—
RMBS – Non-Agency	396,798	33,096	(31,126)	398,768	(74,528)
CMBS	1,223,313	39,255	(15,773)	1,246,795	(2,753)
CDO	754,414	5,833	(42,934)	717,313	(2,036)
Other asset-backed securities (5)	1,210,384	40,560	(8,840)	1,242,104	(2,807)
U.S. States and political subdivisions of the States	1,821,499	55,083	(30,770)	1,845,812	—
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	4,878,840	80,961	(84,260)	4,875,541	—
Total fixed maturities - AFS	\$27,111,874	\$807,684	\$(419,422)	\$27,500,136	\$(86,882)
Total short-term investments (2)	\$455,470	\$962	\$(144)	\$456,288	\$—
Total equity securities (6)	\$903,201	\$154,506	\$(17,470)	\$1,040,237	\$—
Total investments - AFS	\$28,470,545	\$963,152	\$(437,036)	\$28,996,661	\$(86,882)
Fixed maturities - HTM					
U.S. Government and Government-Related/Supported (2)	\$10,993	\$629	\$—	\$11,622	\$—
Corporate	1,386,863	113,179	(968)	1,499,074	—
RMBS – Non-Agency	66,987	4,985	—	71,972	—
CMBS	144,924	11,864	—	156,788	—
Other asset-backed securities (5)	106,540	6,908	—	113,448	—
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2)	1,142,388	136,585	(642)	1,278,331	—
Total investments - HTM	\$2,858,695	\$274,150	\$(1,610)	\$3,131,235	\$—

(1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

(2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$2,241.5 million and fair value of \$2,275.6 million and U.S. Agencies with an amortized cost of \$267.0 million and fair value of \$284.3 million.

(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 \$154.6 million and an amortized cost of \$147.7 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 \$282.2 million and an amortized cost of \$286.2 million.

(5)

Covered Bonds within Fixed maturities - AFS with an amortized cost of \$526.4 million and a fair value of \$553.1 million and Covered Bonds within Fixed maturities - HTM with an amortized cost of \$8.6 million and a fair value of \$8.7 million are included within Other asset-backed securities to align the Company's classification to market indices.

(6) Included within Total equity securities are investments in fixed income funds with a fair value of \$87.4 million and an amortized cost of \$100.0 million.

At March 31, 2014 and December 31, 2013, approximately 2.5% and 2.6%, 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 15.0% and 12.4% of the gross unrealized losses in the Company's fixed income securities portfolio at March 31, 2014 and December 31, 2013, respectively, related to securities that were below investment grade or not rated.

## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Contractual Maturities Summary

The contractual maturities of AFS and HTM fixed income securities at March 31, 2014 and December 31, 2013 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.

(U.S. dollars in thousands)	March 31, 2014 (1)		December 31, 2013 (1)	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Fixed maturities - AFS				
Due less than one year	\$2,209,571	\$2,222,523	\$2,052,251	\$2,060,365
Due after 1 through 5 years	10,037,689	10,290,224	10,075,087	10,305,986
Due after 5 through 10 years	5,263,018	5,400,185	5,474,120	5,507,450
Due after 10 years	2,311,574	2,483,332	2,385,406	2,475,233
	\$19,821,852	\$20,396,264	\$19,986,864	\$20,349,034
RMBS – Agency	3,186,504	3,222,483	3,540,101	3,546,122
RMBS – Non-Agency	389,181	401,393	396,798	398,768
CMBS	1,172,597	1,198,312	1,223,313	1,246,795
CDO	758,469	725,060	754,414	717,313
Other asset-backed securities	1,156,561	1,196,312	1,210,384	1,242,104
Total mortgage and asset-backed securities	\$6,663,312	\$6,743,560	\$7,125,010	\$7,151,102
Total fixed maturities - AFS	\$26,485,164	\$27,139,824	\$27,111,874	\$27,500,136
Fixed maturities - HTM				
Due less than one year	\$67,170	\$68,553	\$65,651	\$66,766
Due after 1 through 5 years	268,264	285,906	240,802	255,322
Due after 5 through 10 years	558,210	626,387	455,633	492,095
Due after 10 years	1,642,287	1,878,378	1,778,158	1,974,844
	\$2,535,931	\$2,859,224	\$2,540,244	\$2,789,027
RMBS – Non-Agency	67,037	73,780	66,987	71,972
CMBS	145,005	160,220	144,924	156,788
Other asset-backed securities	106,514	115,951	106,540	113,448
Total mortgage and asset-backed securities	\$318,556	\$349,951	\$318,451	\$342,208
Total fixed maturities - HTM	\$2,854,487	\$3,209,175	\$2,858,695	\$3,131,235

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 (1) values of \$279.8 million and \$282.2 million at March 31, 2014 and December 31, 2013, respectively. These securities are reflected in the table based on their call date and have net unrealized losses of \$1.6 million and \$4.0 million at March 31, 2014 and December 31, 2013, 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 impairment”) 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 that it will be required to sell such a security, the entire difference between the security's amortized cost and its fair value is recognized in earnings.



## XL GROUP PLC

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

Factors considered for all securities on a quarterly basis 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 March 31, 2014 and December 31, 2013, the Company had \$15.6 billion and \$15.5 billion in pledged assets, respectively.

## (b) Gross Unrealized Losses

The following is an analysis of how long the AFS and HTM securities at March 31, 2014 and December 31, 2013 had been in a continual unrealized loss position:

	Less than 12 months		Equal to or greater than 12 months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
March 31, 2014 (U.S. dollars in thousands)				
Fixed maturities and short-term investments - AFS				
U.S. Government and Government-Related/Supported	\$ 1,184,414	\$(21,102 )	\$ 29,951	\$(1,862 )
Corporate	2,097,447	(36,002 )	452,530	(43,503 )
RMBS – Agency	991,462	(28,596 )	145,427	(10,213 )
RMBS – Non-Agency	6,412	(195 )	232,860	(24,429 )
CMBS	188,965	(3,671 )	107,903	(6,896 )
CDO	126,159	(544 )	557,163	(36,514 )
Other asset-backed securities	73,704	(1,136 )	80,190	(5,332 )
U.S. States and political subdivisions of the States	238,854	(7,318 )	112,668	(7,173 )
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	1,444,095	(31,908 )	433,789	(22,871 )
Total fixed maturities and short-term investments - AFS	\$ 6,351,512	\$(130,472 )	\$ 2,152,481	\$(158,793 )
Total equity securities	\$ 187,067	\$(18,756 )	\$—	\$—
Fixed maturities -HTM				
Corporate	\$ 11,347	\$(171 )	\$ 595	\$(19 )
Total fixed maturities - HTM				