XL CAPITAL LTD
Form 10-K
March 02, 2009

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

FORM 10-K

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

For the fiscal year ended December 31, 2008
OR

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

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

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

Cayman Islands (State or other jurisdiction of incorporation or organization)	98-0191089 (I.R.S. Employer Identification No.)
XL House, One Bermudiana Road Hamilton, Bermuda HM 11 (Address of principal executive offices and zip code)	(441) 292-8515 (Registrant s telephone number, including area code)

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

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

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

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

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

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

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

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

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

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

The aggregate market value of the voting common equity of the registrant held by non-affiliates of the registrant on June 30, 2008 was approximately $3.7 billion computed upon the basis of the closing sales price of the Class A Ordinary Shares on June 30, 2008. For purposes of this computation, ordinary shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 25, 2009, there were outstanding 342,210,169 Class A Ordinary Shares, $0.01 par value per share, of the registrant.

Documents Incorporated by Reference

The Registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report relating to the annual meeting of ordinary shareholders to be held on April 24, 2009 is incorporated by reference into Part III of this Form 10-K.

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

PART I

ITEM 1. BUSINESS

History

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

EXEL Limited and Mid Ocean Limited are companies that were incorporated in the Cayman Islands in 1986 and 1992, respectively. At a special general meeting held on February 1, 1999, the shareholders of the Company approved a resolution changing the name of the Company to XL Capital Ltd.

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

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

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

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

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

Segments

The Company is organized into four operating segments: Insurance, Reinsurance, Life Operations, and Other Financial Lines   in addition to a Corporate segment that includes the general investment and financing operations of the Company.

The Company evaluates the performance for both the Insurance and Reinsurance segments based on underwriting profit and evaluates the contribution from each of the Life Operations and Other Financial Lines segments. 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 (i) the Company s Life Operations and Other Financial Lines segments and (ii) certain structured products included in the Insurance and Reinsurance segments are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these segments.

The following table sets forth an analysis of gross premiums written by segment for the years ended December 31, 2008, 2007 and 2006. Additional financial information about the Company s segments, including financial information about geographic areas, is included in Item 8, Note 6 to the Consolidated Financial Statements, Segment Information.

Year ended December 31 *(U.S. dollars in thousands)*	**2008 Gross Premiums Written**	**Percentage Change**	**2007 Gross Premiums Written**	**Percentage Change**	**2006 Gross Premiums Written**
Insurance	$ 5,308,914	(2.3)%	$ 5,434,266	(3.4)%	$ 5,627,293
Reinsurance	2,260,477	(15.1)%	2,663,494	(13.1)%	3,066,138
Life Operations	690,915	(7.0)%	743,220	8.2 %	686,906
Syncora (1)		(100.0)%	156,983	(61.3)%	405,910
	$ 8,260,306	(8.2)%	$ 8,997,963	(8.1)%	$ 9,786,247

(1) Gross premiums written relating to Syncora in 2007 are for the period from January 1, 2007 through June 6, 2007, the date on which the Company completed the sale of a portion of Syncora s common shares then owned by the Company, through a secondary

offering and thereby reduced its ownership of Syncora s outstanding common shares from approximately 63% to approximately 46%. From June 6, 2007 until the execution of the Master Agreement, the Company accounted for its remaining investment in Syncora using the equity method of accounting. Subsequent to August 5, 2008, the Company has no further ownership interest in Syncora.

Insurance Segment

General

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

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

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

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

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

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

Excess and surplus lines products include both general liability and property coverages. For general liability, most Insurance Services Office, Inc. products are written. For property, limits are relatively low and coverages exclude flood, earthquake and difference in conditions.

The Company s program business specializes in insurance coverages for distinct market segments in North America, including program administrators and managing general agents who operate in a specialized market niche and have unique industry backgrounds or specialized underwriting capabilities. Products encompass automobile extended warranty and other property and casualty coverage. The Company implemented an exit strategy for its small commercial property catastrophe coverage program in 2006 and has decided to exit the automobile extended warranty business in 2009.

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

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

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

U.S. Terrorism

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

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

Non-U.S. Terrorism

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

Underwriting

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

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

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

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

Reinsurance Ceded

In certain cases, the risks assumed by the Company in the Insurance segment are partially reinsured with third party reinsurers. Reinsurance ceded varies by location and line of business based on a number of factors, including market conditions. The benefits of ceding risks to third party reinsurers include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. Reinsurance ceded does not legally discharge the Company from its liabilities to the original policyholder in respect of the risk being reinsured.

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

Premiums

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

The following table is an analysis of the Insurance segment s gross premiums written, net premiums written and net premiums earned, by line of business for the year ended December 31, 2008:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Casualty professional lines	$ 1,472,874	$ 1,351,237	$ 1,369,668
Casualty other lines	1,273,016	793,512	822,252
Property catastrophe	(65)	(2,177)	270
Other property	886,483	505,564	471,013
Marine, energy, aviation and satellite	747,311	604,786	621,774
Other specialty lines (1)	850,404	712,307	660,322
Other (2)	22,736	(22,908)	(11,055)

Structured indemnity	56,155	42,505	62,801
Total	$ 5,308,914	$ 3,984,826	$ 3,997,045

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

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

Competition

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

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

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

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

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

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

Marketing and Distribution

The majority of Insurance Segment business originates via a large number of international, national and regional producers, acting as the agents and representatives of current and prospective policyholders. A portion of Insurance Segment business is marketed and underwritten by general agents and independent agents acting on behalf of the Company. Typically, all such producers, general agents, and independent agents receive commission payments from the Company for their services, which payments are calculated as a percentage of gross premium paid by the policyholder on an account-by-account basis. A certain portion of business originating from producers is submitted on a fee basis under which the producer is compensated by a fee paid to it by its policyholder client. With regard to fee only business, the Company has considered requests from certain producers to provide commissions in addition to fees paid to such producers. After evaluation, such fees are paid, on a case by case basis, with disclosure by the producer to the policyholder-client.

In the past, the Company has also entered into contingent commission arrangements with some producers that provided for the payment of additional commissions based on such variables as production of new and renewal business or the retention of business. Going forward, the Company intends to entertain requests for additional commission arrangements only where such additional commissions are based upon the volume of bound business originating from a specific broker during a prior calendar year. Such arrangements are distinct from program business where additional commissions are generally based on profitability of business submitted to and bound by the Company.

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

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

Claims Administration

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

Claims in respect of business written by the Company s Lloyd s syndicates are primarily notified by various central market bureaus. Where a syndicate is a leading syndicate on a Lloyd s policy, its underwriters and claims adjusters will deal with the broker or insured on behalf of itself and the following market for any particular claim. This may involve appointing attorneys or loss adjusters. The claims bureau and the leading syndicate advise movement in loss reserves to all syndicates participating on the risk. The Company s claims department may adjust the case reserves it records from those advised by the bureau as deemed necessary.

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

Reinsurance Segment

General

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

Business written on a non-proportional basis generally provides for an indemnification by the Company to the ceding company for a portion of losses both individually and in the aggregate, on policies with limits in excess of a specified individual or aggregate loss deductible. For business written on a proportional bases including quota share or surplus basis, the Company receives an agreed percentage of the premium and is liable for the same percentage of each and all incurred loss. For proportional business, the ceding company normally receives a ceding commission for the premiums ceded and may also, under certain circumstances, receive a profit commission. Occasionally this commission could be on a sliding scale depending on the loss ratio performance in which case there is generally no profit commission. Reinsurance may be written on a portfolio/treaty basis or on an individual risk/facultative basis. The treaty business is mainly underwritten using reinsurance intermediaries while the individual risk business is generally underwritten directly with the ceding companies, especially for business written in the U.S.

The Company s casualty reinsurance includes general liability, professional liability, automobile and workers compensation. Professional liability includes directors and officers , employment practices, medical malpractice, and environmental liability. Casualty lines are written as treaties, programs as well as on an individual risk basis and on both a proportional and a non-proportional basis. The treaty business includes clash programs which cover a number of underlying policies involved in one occurrence or a judgment above an underlying policy s limit, before suffering a loss.

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

The Company seeks to manage its reinsurance exposures to catastrophic events by limiting the amount of exposure written in each geographic or peril zone worldwide, underwriting in excess of varying attachment points and requiring that contracts exposed to catastrophe loss include aggregate limits. The Company also seeks to protect its total aggregate exposures by peril and zone through the purchase of reinsurance programs.

The Company s property catastrophe reinsurance account is generally all risk in nature. As a result, the Company is exposed to losses from sources as diverse as hurricanes and other windstorms, earthquakes, freezing, riots, floods, industrial explosions, fires, and many other potential natural or man-made disasters. In accordance with market practice, the Company s policies generally exclude certain risks such as war, nuclear contamination or radiation. Following the terrorist attacks at the World Trade Center in New York City, in Washington, D.C. and in Pennsylvania on September 11, 2001 (collectively, the September 11 event), terrorism cover, including NBRC, has been restricted or excluded in many territories and classes. Some U.S. States make it mandatory to provide some cover for Fire Following terrorism and some countries make terrorism coverage mandatory. The Company s predominant exposure under such coverage is to property damage.

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

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

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

Other specialty reinsurance products include energy, marine, aviation, space, engineering, fidelity, trade credit, and political risk.

The Company underwrites a small portfolio of contracts covering political risk and trade credit. Exposure is assumed from a limited number of trade credit contracts and through Lloyd s quota shares. In addition, there are runoff exposures from discontinued writings in the Company s marine portfolio.

The results of certain transactions previously structured by XLFS that were generally written on an aggregrate stop loss or excess of loss basis are included within the results of the Reinsurance segment. In August 2008, the Company ceased certain operations that included the closure of the XLFS business unit and reassignment of responsibility for existing structured indemnity business to either the Insurance segment or Reinsurance segment depending on the underlying nature of the transactions.

Underwriting

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

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

For property catastrophe reinsurance business, the Company s underwriting guidelines generally limit the amount of exposure it will directly underwrite for any one reinsured and the amount of the aggregate exposure to catastrophic losses in any one geographic zone. The Company believes that it has defined geographic and peril zones such that a single occurrence, for example an earthquake or hurricane, should not affect more than one peril zone. While the exposure to multiple zones is considered remote for events such as a hurricane, the Company does manage its aggregate exposures for such a scenario where the Company considers it appropriate to do so. The definition of the Company s peril zones is subject to periodic review. The Company also generally seeks an attachment point for its property catastrophe reinsurance at a level that is high enough to produce a low frequency of loss. The Company seeks to limit its aggregate exposure in the proportional business through extensive use of occurrence and cession limits.

Reinsurance Retroceded

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

Upon expiration of the Company s quota share reinsurance treaty with Cyrus Re which reduced the Company s catastrophe exposures, the Company, effective January 1, 2008, entered into a quota share reinsurance treaty with a newly-formed Bermuda reinsurance company, Cyrus Re II. Pursuant to the terms of the quota share reinsurance treaty, Cyrus Re II assumed a 10% cession of certain lines of property catastrophe reinsurance and retrocession business underwritten by certain operating subsidiaries of the Company for business that incepted between January 1, 2008 and July 1, 2008. In connection with such cessions, the Company paid Cyrus Re II reinsurance premium less a ceding commission, which included a reimbursement of direct acquisition expenses incurred by the Company as well as a commission to the Company for generating the business. The quota share reinsurance treaty also provided for a profit commission payable to the Company. Following the Company s evaluation of its exposures and the current market conditions, Cyrus Re II was canceled and not renewed at December 31, 2008.

The traditional catastrophe retrocession program was renewed in June 2008 to cover certain of the Company s exposures net of Cyrus Re II cessions. These protections, in various layers and in excess of varying attachment points according to the territory exposed, assist in managing the Company s net retention to an acceptable level. The Company has co-reinsurance retentions within this program. The

Company renewed additional structures with a restricted territorial scope for 12 months at July 2008. The Company continued to buy additional protection for the Company s marine and offshore energy exposures. These covers provide protection in various layers and excess of varying attachment points according to the scope of cover provided. The Company has co-reinsurance participations within this program.

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

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

Premiums

The following table is an analysis of the Reinsurance segment s gross premiums written, net premiums written and net premiums earned, by line of business for the year ended December 31, 2008:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Casualty professional lines	$ 213,519	$ 213,498	$ 247,979
Casualty other lines	356,723	347,849	425,541
Property catastrophe	401,740	290,443	305,690
Other property	947,899	602,423	678,504
Marine, energy, aviation and satellite	119,593	104,346	126,761
Other (1)	220,332	194,237	205,433
Structured indemnity	671	671	3,298
Total	$ 2,260,477	$ 1,753,467	$ 1,993,206

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

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

Competition

The Company competes globally in the property and casualty markets.

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

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

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

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

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

Marketing and Distribution

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

Structure of Reinsurance Operations

The Company s reinsurance operations are structured geographically into Bermuda operations, North American operations, European operations and Emerging Markets operations (covering Asia/Pacific and South America).

Claims Administration

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

Life Operations Segment

In August 2008, the Company announced its intention to review strategic opportunities relating to its Life reinsurance business. In relation to this initiative, the Company sold the renewal rights to its Continental European short-term life, accident and health business in late 2008, a relatively small block managed by a team in France that also transferred to the purchaser as part of the transaction. The Company continues to explore various strategic options for the remainder of its Life Operations business.

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

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

The portfolio has three particularly significant components:

1) The portfolio includes a small number of large contracts relating to closed blocks of U.K. and Irish fixed annuities in payment. In relation to certain of these contracts, the Company receives cash and investment assets at the inception of the reinsurance contract, relating to the future policy benefit reserves assumed. These contracts are long-term in nature, and the expected claims payout period can span up to 30 or 40 years with average duration of around 10 years. The Company is exposed to investment and survivorship risk over the life of these arrangements.

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

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

Underwriting & Claims Administration

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

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

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

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

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

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

Reinsurance Retroceded

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

Premiums

The following table is an analysis of the Life operations gross premiums written, net premiums written and net premiums earned for the year ended December 31, 2008:

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Other Life	$ 498,387	$ 492,346	$ 492,353
Annuity	192,528	157,498	157,498
Total	$ 690,915	$ 649,844	$ 649,851

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

Competition

In regards to Life Operations business, the core activity is in the U.S., U.K. and Continental Europe.

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

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

Marketing and Distribution

The Company predominantly markets its long-term products directly to clients, with a smaller element sourced through reinsurance intermediaries. For these products, the marketing hinges on relationships developed by the Company with client companies   particularly through professional contacts within the actuarial and underwriting communities.

The Company primarily marketed the short-term life, accident and health business through reinsurance intermediaries. Following the sale of the renewal rights, the Company has ceased to market these product lines.

The Company maintains good relations with the broking community as well as with a wide range of professional advisory firms (actuarial and accounting) from whom opportunities may be referred.

The Company s distribution strategy has been to avoid any undue concentration on any single client or market. For treaties relating to new business, there is an effort to target ceding companies which are themselves strong and growing in their target segments. This prioritization of potential clients is based on analysis of public, market information.

Other Financial Lines Segment

The Other Financial Lines segment is comprised of remaining contracts associated with the funding agreement (FA) business and previously included the guaranteed investment contract (GIC) business. GICs and FAs provide users guaranteed rates of interest on amounts previously invested with the Company. FAs are very similar to GICs in that they have known cash flows. FAs were sold to institutional investors, typically through medium term note programs. As at December 31, 2007, the Company had approximately $4.0 billion of deposit liabilities associated with GICs which were correspondingly matched with invested assets. Based on the terms and conditions of the underlying GICs, upon the downgrade of Syncora Guarantee below certain ratings levels, all or portions of outstanding principal balances on such GICs would come due. Throughout 2008, several rating agencies downgraded Syncora and its subsidiaries and, as a result, the Company settled, in 2008 all of the GIC liabilities. In addition, certain funding agreement contracts matured, resulting in the settlement of the underlying principal and accrued interest. At December 31, 2008, the remaining balance of funding agreements, excluding accrued interest of $6.6 million, was $600.0 million, with settlements scheduled as follows: $150.0 million in October 2009 and $450.0 million in August 2010.

Unpaid Losses and Loss Expenses

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

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

The tables below present the development of the Company s unpaid losses and loss expense reserves on both a net and gross basis. The cumulative redundancy (deficiency) calculated on a net basis differs from that calculated on a gross basis. As different reinsurance programs cover different underwriting years, net and gross loss experience will not develop proportionately. The top line of the tables shows the estimated liability, net of reinsurance recoveries, as at the year end balance sheet date for each of the indicated years. This represents the estimated amounts of losses and loss expenses, including IBNR, arising in the current and all prior years that are unpaid at the year end balance sheet date of the indicated year. The tables show the re-estimated amount of the previously recorded reserve liability based on experience as of the year end balance sheet date of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual years. The cumulative redundancy (deficiency) represents the aggregate change with respect to that liability originally estimated. The lower portion of the first table also reflects the cumulative paid losses relating to these reserves. Conditions and trends that have affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies into the future, based on the tables below. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

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

(U.S. dollars in millions)	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
ESTIMATED LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES, NET OF REINSURANCE RECOVERABLES	$ 4,303	$ 4,537	$ 4,207	$ 7,004	$ 8,313	$ 10,5
LIABILITY RE-ESTIMATED AS OF:						
One year later	4,016	4,142	4,382	7,404	9,250	10,8
Two years later	3,564	4,085	4,345	8,423	9,717	11,8
Three years later	3,580	4,120	5,118	8,653	10,723	11,8
Four years later	3,461	4,624	5,294	9,727	10,738	11,8
Five years later	3,742	4,747	5,435	9,674	10,710	11,6
Six years later	3,774	4,858	5,419	9,718	10,642	
Seven years later	3,872	4,872	5,508	9,680		
Eight years later	3,833	4,927	5,496			
Nine years later	3,868	4,926				
Ten years later	3,878					
CUMULATIVE REDUNDANCY (DEFICIENCY) (1)	425	(389)	(1,289)	(2,676)	(2,329)	(1,1
CUMULATIVE PAID LOSSES, NET OF REINSURANCE RECOVERIES, AS OF:						
One year later	$ 812	$ 1,252	$ 1,184	$ 2,011	$ 2,521	$ 1,9
Two years later	1,594	1,828	1,920	3,984	3,800	2,8
Three years later	1,928	2,306	2,683	4,703	4,163	4,3
Four years later	2,249	2,824	3,038	4,641	5,365	5,2
Five years later	2,555	3,035	3,290	5,526	6,018	6,2

Six years later	2,741	2,807	3,774	5,969	6,764
Seven years later	2,856	3,110	3,985	6,514	
Eight years later	3,059	3,240	4,351		
Nine years later	3,029	3,482			
Ten years later	3,350				

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

(U.S. dollars in millions)	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
ESTIMATED GROSS LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES	$ 4,897	$ 5,369	$ 5,668	$ 11,807	$ 13,333	$ 16,55
LIABILITY RE-ESTIMATED AS OF:						
One year later	$ 4,735	$ 5,266	$ 6,118	$ 12,352	$ 15,204	$ 18,18
Two years later	4,352	5,147	6,105	14,003	16,994	18,52
Three years later	4,316	5,176	6,909	15,377	17,210	18,32
Four years later	4,232	5,663	7,086	15,441	17,048	18,36
Five years later	4,508	5,798	7,240	15,267	17,106	18,23
Six years later	4,568	5,890	7,223	15,401	17,051	
Seven years later	4,658	5,881	7,317	15,381		
Eight years later	4,629	5,957	7,370			
Nine years later	4,681	5,960				
Ten years later	4,682					
CUMULATIVE REDUNDANCY (DEFICIENCY)	215	(591)	(1,702)	(3,574)	(3,718)	(1,68

(1) Excludes $351.0 million of financial guarantee

reserves previously related to reinsurance agreements with Syncora.

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

Reconciliation of Unpaid Losses and Loss Expenses

(U.S. dollars in thousands)	**2008**	**2007**	**2006**
Unpaid losses and loss expenses at beginning of year	$ 23,207,694	$ 22,895,021	$ 23,597,815
Unpaid losses and loss expenses recoverable	4,665,615	4,995,373	6,396,984
Financial guarantee reserves related to previous reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates	(350,988)		
Net unpaid losses and loss expenses at beginning of year	18,191,091	17,899,648	17,200,831
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:			
Current year	4,573,562	4,266,444	4,311,798
Prior years	(610,664)	(425,441)	(110,604)
Total net incurred losses and loss expenses	3,962,898	3,841,003	4,201,194
Exchange rate effects and other adjustments	(677,664)	421,575	355,500
Net loss reserves (disposed) acquired (1)		(155,259)	40,184
Less net losses and loss expenses paid in respect of losses occurring in:			
Current year	584,120	627,748	460,853
Prior years	3,206,726	3,188,128	3,437,208
Total net paid losses	3,790,846	3,815,876	3,898,061
Net unpaid losses and loss expenses at end of year	17,685,479	18,191,091	17,899,648
Financial guarantee reserves related to reinsurance agreements that existed at December 31, 2007 with Syncora that were recorded within Net loss from operating affiliates		350,988	
Unpaid losses and loss expenses recoverable	3,964,836	4,665,615	4,995,373
Unpaid losses and loss expenses at end of year	$ 21,650,315	$ 23,207,694	$ 22,895,021

The Company s net unpaid losses and losses expenses (excluding in 2007, financial guarantee reserves previously related to reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates) relating to the Company s operating segments at December 31, 2008 and 2007 were as follows:

(U.S. dollars in millions)	**December 31, 2008**	**December 31, 2007**
Insurance	$ 11,126	$ 11,138
Reinsurance	6,559	7,053
Net unpaid loss and loss expense reserves	$ 17,685	$ 18,191

Current year net losses incurred

Net losses incurred increased by $307.1 million in 2008 as compared to 2007, mainly as a result, of the current year loss ratio increasing by 10.0 loss percentage points during the same period, primarily due to an increase in attritional and catastrophe-related property losses, an increase in professional lines loss ratio and the impact of a softening rate environment. Business volume reduced as net premiums earned related to the Company s P&C operations decreased by 6.7% over this period. Overall, windstorm activity in the Atlantic and Gulf regions increased in 2008 as compared to 2007 and included the impacts of Hurricanes Gustav and Ike, which both made landfall in the U.S. in the third quarter of 2008. Hurricane Ike was estimated to have caused the third largest ever insured loss in the U.S. from a wind storm. Combined, Hurricanes Gustav and Ike had a significant impact on the results of the Company for the year ended December 31, 2008. Based on reports and estimates of loss and damage as at December 31, 2008, the

Company estimated losses incurred, net of reinsurance recoveries and reinstatement premiums, of $22.5 million and $210.0 million related to Hurricanes Gustav and Ike, respectively.

Net losses incurred for 2007 (excluding financial guarantee reserves previously related to reinsurance agreements with Syncora that were recorded within Net loss from operating affiliates) decreased from 2006 due to a reduction in business volume as the Company s net premiums earned decreased by 4.6% from 2006 to 2007. However, the current year loss ratio increased by 2.4 loss percentage points from 2006 to 2007 as a result of an increase in attritional and catastrophe-related property experience as well as the impact of a softening rate environment. In 2007, six hurricanes formed in the Atlantic region including two Category 5 hurricanes, one of which, Hurricane Dean, resulted in a limited amount of insured damage to areas of Mexico affected by the hurricane. Other natural catastrophes in 2007 included European windstorms Kyrill and Per/Hanno, California wildfires, floods in the U.K. and Mexico, the Peruvian earthquake and five hurricanes in the Eastern Pacific region. In 2006, there were only five hurricanes in the Atlantic region and more importantly there was no significant insured damage for those hurricanes that did make landfall.

Prior year net losses incurred

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

Gross *(U.S. dollars in millions)*	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 22,857	$ 22,895	$ 23,598
Net (favorable) adverse development of those reserves during the year	(1,054)	(437)	(389)
Unpaid losses and loss expense reserves re-estimated one year later	$ 21,803	$ 22,458	$ 23,209

Net *(U.S. dollars in millions)*	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 18,191	$ 17,900	$ 17,201
Net (favorable) adverse development of those reserves during the year	(611)	(425)	(111)
Unpaid losses and loss expense reserves re-estimated one year later	$ 17,580	$ 17,475	$ 17,090

As different reinsurance programs cover different underwriting years, contracts and lines of business, net and gross loss experience do not develop proportionately. In 2008, gross prior year favorable development exceeded net prior year favorable development in both the Reinsurance and Insurance segments. Within the Reinsurance segment, the gross impact of favorable loss experience related to a large crop program was mostly offset by the impact of retrocessional protection related to this program. In the Insurance segment, the impact of reductions in gross reported losses on older years in certain casualty lines was mostly offset by the impact of the reinsurance recoverable component on such losses, while the impact of gross reserve releases in professional and specialty lines was mostly offset by the impact of a reduction in estimated ceded IBNR following a reserve review in these lines.

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

(U.S. dollars in millions)		**2008**		**2007**		**2006**
Insurance segment	$	(305.5)	$	(158.1)	$	(13.2)
Reinsurance segment		(305.2)		(267.3)		(97.4)
Total	$	(610.7)	$	(425.4)	$	(110.6)

During 2008, net favorable prior year development totaled $610.7 million in the Company s property and casualty operations and included net favorable development in the Insurance and Reinsurance segments of $305.5 million and $305.2 million, respectively. Within the Reinsurance segment, net favorable prior year reserve development included casualty and other lines reserve releases in both European and U.S.

casualty and professional portfolios as well as reserve releases associated with the reinsurance-to-close relating to the 2005 year of account on certain Lloyd s sourced business. In the same period, property and other short-tail lines net favorable development was attributable to most business units globally. The Insurance segment net favorable prior year reserve development was due to reserve releases in global property lines of business as a result of favorable claim development as well as reserve releases in certain casualty lines primarily in 2003 to 2006 accident years due to lower than expected reported loss activity. In addition, net reserve releases of approximately $80.9 million resulted from a favorable settlement in the fourth quarter of 2008 in regards to certain reinsurance recoverable balances relating to casualty lines and to a lesser extent, certain property lines of business. Offsetting this favorable development was modest reserve strengthening within environmental lines as well as strengthening associated with certain structured indemnity contracts. Within the professional lines, reserve releases in the 2003 to 2006 accident years were largely offset by strengthening of reserves in the 2007 year.

During 2007, the Company had net favorable prior year reserve development in property and casualty operations of $425.4 million. Reinsurance net favorable development accounted for $267.3 million of the release in 2007, while net favorable development within the Insurance segment totaled $158.1 million for the same period. The corresponding prior year development on a gross basis was $259.7 million for the Reinsurance segment and $177.6 million for the Insurance segment. Within the Reinsurance segment, reserve releases of $188.7 million in property and other short-tail lines of business and $87.4 million in casualty and other lines, were partially offset by adverse prior year development of $8.8 million within the structured indemnity line of business. The Insurance segment net prior year reserve releases consisted of $95.0 million in property and $162.1 million in casualty lines of business, partially offset by net adverse development of $23.0 million, $7.0 million and $69.0 million in certain professional, marine and other lines of business, respectively.

During 2006, the Company had net favorable prior year reserve development in property and casualty operations of $110.6 million. Within the Insurance segment, net overall favorable prior year reserve development for the year ended December 31, 2006, was $13.2 million, while net favorable development within the Reinsurance segment during the same period was $97.4 million.

See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 12 to the Consolidated Financial Statements, Losses and Loss Expenses , for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of the Company s operating segments.

Net loss reserves (disposed) acquired

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

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

During 2006, the Company acquired $40.2 million in losses through a loss portfolio transfer contract structured by XLFS.

Exchange rate effects

Exchange rate effects on net loss reserves in each of the three years ended December 31, 2008 related to the global operations of the Company primarily where reporting units have a functional currency that is not the U.S. dollar. The increase in the value of the U.S. dollar in 2008 combined with the decrease in the value of the U.S. dollar in 2007 and 2006 mainly compared to the Swiss franc, U.K. Sterling and the Euro, gave rise to translation and revaluation exchange movements related to carried loss reserve balances of $(677.7) million, $421.6 million and $355.5 million in

2008, 2007 and 2006, respectively.

Net paid losses

Total net paid losses were $3.8 billion in each of 2008 and 2007, and $3.9 billion and 2006, respectively. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for further information.

Other loss related information

The Company s net incurred losses and loss expenses include actual and estimates of potential non-recoveries from reinsurers. As at December 31, 2008 and 2007, the reserve for potential non-recoveries from reinsurers was $187.6 million and $193.1 million, respectively. For further information, see Note 13 to the Consolidated Financial Statements, Reinsurance.

Except for certain workers compensation and certain financial guarantee liabilities, the Company does not discount its unpaid losses and loss expenses. The Company utilizes tabular reserving for workers compensation unpaid losses that are considered fixed and determinable, and discounted such losses using an interest rate of 5% in 2008 (2007: 5%). In addition, the Company has also used a rate of approximately 5% to discount financial guarantee liabilities. The tabular reserving methodology associated with workers compensation liabilities results in applying uniform and consistent criteria for establishing expected future indemnity and medical payments (including an explicit factor for inflation) and the use of mortality tables to determine expected payment periods. Tabular unpaid losses and loss expenses, net of reinsurance, at December 31, 2008 and 2007 were $755.8 million and $813.7 million, respectively. The related discounted unpaid losses and loss expenses were $346.0 million and $377.0 million as of December 31, 2008 and 2007, respectively. Financial guarantee case reserves at December 31, 2008 and 2007 were $14.5 million and $427.4 million, respectively.

Investments

Investment structure and strategy

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

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and build book value for the Company over the longer term. However, recent turmoil in the global markets in late 2007 and throughout 2008 has resulted in an increase in realized and unrealized losses as well as lower net investment income yields and losses on investment fund affiliates. Following the Company s announcement that will see it focus on its P&C operations, the Company announced its intention to reposition the Company investment portfolio to one that supports a more focused P&C operation. The Company began repositioning the portfolio in 2008 so that a) future book value volatility particularly related to credit spreads arising from the portfolio is reduced, b) a reduction in lower rated corporate securities and financial issuers is achieved, c) exposure to CMBS securities is reduced and d) a reduction in asset classes such as subprime, Alt-A and Core CDO s previously supporting Other Financial Lines activities is achieved. Realignment will be achieved primarily through cash generated from bond maturities and coupon reinvestment, cash flow from business operations as well as certain opportunistic sales.

Consistent with this strategy, management continued the process of reducing risk in the investment portfolio during the latter part of 2008. Fannie Mae and Freddie Mac preferred positions were sold as well as securities of a number of regional banks. Most of this was accomplished prior to the bankruptcy of Lehman Brothers Holdings Inc. (Lehman) in September 2008 when credit markets became even more disrupted. In addition, management reduced the aggregate sub-prime, Alt A, CMBS and CDO portfolio holdings significantly, through maturities and turnover in the ordinary course of business and certain

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opportunistic sales, in particular $1.6 billion in the CMBS portfolio, as well as reduced the aggregate corporate portfolios by $1.2 billion.

In addition, in the fourth quarter of 2008, management recorded a charge for other-than-temporary impairments (OTTI) of $400.0 million for which it could no longer assert its intent to hold until recovery. Although management believes these securities are likely to recover to their current amortized cost, it determined that these securities were at-risk for further mark-to-market declines, and potentially real economic losses, to the extent that economic conditions were to deteriorate further than present estimates and the Company s allocation to these asset classes is overweight relative to a traditional P&C portfolio. Accordingly, in conjunction with its risk reduction exercise, management is likely to pursue targeted sales of these assets over the course of 2009. The assets are concentrated in certain holdings within the Company s BBB and lower corporate, CMBS, equity and consumer ABS portfolios.

The Company reduced its risk exposure to alternative investments by approximately $0.8 billion during 2008 in response to adverse market conditions and in regards to the risk reduction exercise ongoing within its investment portfolio. Management further reduced interest rate risk exposure in 2008 by shortening the duration of the portfolio supporting the U.S. property and casualty operations by 0.6 years. Cash and government agency holdings were increased by approximately $2.4 billion to approximately $13.2 billion representing approximately 41.2% of the fixed income portfolio at December 31, 2008. Following the risk reduction steps executed to date, the credit spread of the fixed income portfolio duration has been reduced to 3.1 years as at December 31, 2008.

While the Company seeks to reduce the overall risk within its investment portfolio, it will continue to attempt to balance investment returns against market and credit risks taken. Market risk may arise due to interest rate variability and exposure to foreign denominated currencies, which the Company seeks to manage through asset/liability management, and due to the allocation to risk assets, including global equity securities and alternative investments, which the Company seeks to manage through diversification. Credit risk arises from investments in fixed income securities and is managed with aggregate and portfolio limits and by establishing minimum credit quality guidelines. The Company guidelines require a minimum Aa3/AA weighted-average rating for its fixed income portfolio.

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

The Company s investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance. At December 31, 2008 and 2007, total investments, cash and cash equivalents and accrued investment income, less net receivable (payable) for investments sold (purchased), were $34.3 billion and $43.7 billion, respectively.

Functionally, the Company s investment portfolio is divided into three principal components:

1) Asset/Liability Portfolio: The largest component is the asset/liability portfolio which is intended to support the liabilities arising from the property and casualty as well as the life operations of the Company.

From a functional perspective, the asset/liability portfolio is allocated into two sub portfolios: a) the P&C general account portfolio and b) the structured and spread product portfolio.

The P&C general account portfolio is the largest component of the Company s investment portfolio and primarily supports the property and casualty liabilities of the Company as well as provides liquidity to settle claims arising from the Company s property and casualty operations. The P&C general account portfolio is made up entirely of investment grade fixed income securities and its primary strategy focuses on diversification of asset maturities relative to the expected cash flows of the property and casualty operation. The P&C general portfolio holds Topical (representing subprime, Alt-A, 2nd Lien and ABS CDOs) and Core CDO assets with a fair value of approximately $1.4 billion which supported the previously written GIC and funding agreement contracts. The Company has announced its intention to reduce its exposure to such asset classes over time as part of its long-term strategic portfolio alignment activities. The P&C general account portfolio was approximately $23.1 billion and $24.1 billion at December 31, 2008 and 2007, respectively. As at December 31, 2008, the general account portfolio was approximately 67.3% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 55.3% as at December 31, 2007.

The structured and spread product portfolio consists of highly structured, actively managed investment portfolios that support specific transactions within the Company s Insurance, Reinsurance, Life Operations and Other Financial Lines segments. These represent structured indemnity, annuity products, funding agreement transactions, and previously GIC transactions. As a result of the long duration of assets supporting the Life business, there has been a significant decline in the fair value of these securities as they are more sensitive to prevailing government interest rates and credit spreads. The Company also continues to explore strategic alternatives with respect to the Life Operations segment.

Liquidations necessary to fund the settlement of the remaining GIC liabilities of approximately $4.0 billion throughout 2008 following the downgrade of Syncora Guarantee and the maturity of $1.2 billion funding agreements were funded through the sale of assets in the Other Financial Lines segment investment portfolio as well as the general investment portfolio. Management s approach was to avoid sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold in its general portfolio a significant portion of the assets which previously supported the structured and spread products including GICs, in exchange for those assets that were liquidated.

Assets supporting remaining structured and spread business were approximately $8.0 billion and $14.8 billion at December 31, 2008 and 2007, respectively. As at December 31, 2008, the structured and spread portfolio was approximately 23.4% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 33.8% as at December 31, 2007.

2) The second component of the investment portfolio is the risk asset portfolio, which was approximately $2.8 billion and $4.4 billion at December 31, 2008 and 2007, respectively. The risk asset portfolio is that portion of the Company s capital that is invested in risk assets to generate growth in the Company s book value over the longer term with the efficient utilization of risk. The Company utilizes a risk budgeting framework for the dynamic risk and asset allocation of the risk asset portfolio. The fundamental premise of the risk budgeting methodology for the risk asset portfolio is to maximize expected returns for a given level of risk. The risk asset portfolio includes four core strategy portfolios including: (i) the alternative investment portfolio; (ii) the high yield portfolio; (iii) the public equity portfolio; and (iv) the private investment portfolio.

As part of the overall risk asset portfolio, the Company sets specific constraints during the risk allocation process that reflect the Company s overall tolerance for risk, including guidelines on the level of Value at Risk (VaR) of the risk asset portfolio, stress testing and a maximum drawdown level attributable to the alternative investment portfolio. These levels are approved by the Finance and Risk Oversight Committee of the Company s Board of Directors annually. In addition, each of the core risk asset portfolios is subject to specific investment guidelines that are also approved by the Finance and Risk Oversight Committee of the Company s Board of Directors. These guidelines address the investment parameters and risk associated with each portfolio. The Company monitors the total risk and return of the risk asset portfolio to ensure compliance with the risk target guidelines as approved.

The alternative investment portfolio is a diversified portfolio of investments in limited partnerships and similar investment vehicles, with each fund generally pursuing absolute return investment mandates. These funds are typically investing in one or more of the traditional asset classes including equities, fixed income, credit, currency and commodity markets. For the majority of the portfolio, the Company owns minority investment interests that are accounted for under the equity method and are included in the Consolidated Balance Sheet under Investments in affiliates. The objective of the alternative investment portfolio is to attain an attractive risk-adjusted total return while maintaining a moderate to low level of sensitivity to the movements in traditional asset classes and realizing a low volatility.

Within the alternative investment portfolio, various strategies can be pursued and the Company classifies each fund allocation into four general style categories as follows: (i) Event driven, which includes strategies that pursue merger arbitrage, distressed and special situations opportunities; (ii) Directional/tactical, which includes strategies that pursue long/short equity, managed futures and macro opportunities; (iii) Arbitrage, which includes strategies that pursue equity market neutral, fixed income arbitrage and convertible arbitrage opportunities; and (iv) Multi-strategy, which includes strategies incorporating several aspects of the above.

The alternative investment portfolio had more than 85 separate investments in different funds at December 31, 2008 with a total exposure of $1.1 billion, making up approximately 3.2% of the investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) as compared to December 31, 2007 where the Company had approximately 80 separate fund investments with a total exposure of $2.3 billion representing approximately 5.2% of the investment portfolio.

At December 31, 2008, the alternative investment portfolio allocation was 34% in Directional/tactical strategies, 33% in Arbitrage strategies, 23% in Event driven strategies and 10% in Multi-strategy strategies. At December 31, 2007, the alternative investment portfolio allocation was 47% in Directional/tactical strategies, 25% in Arbitrage strategies, 21% in Event driven strategies and 7% in Multi-strategy strategies.

The high yield portfolio is invested in a diversified portfolio of below investment grade securities, including downgraded securities of predominantly corporate structured credit issuers. The high yield portfolio was approximately $0.8 billion and $0.9 billion at December 31, 2008 and 2007, respectively. As at December 31, 2008 and 2007, the Company s allocation to high yield securities was approximately 2.2% and 2.1%, respectively, of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)).

The equity portfolio is invested in a diversified portfolio of publicly traded equity securities. As at December 31, 2008, the Company s equity portfolio was $0.3 billion as compared to $0.8 billion as at December 31, 2007. This excludes $32.0 million of fixed income fund investments and publicly traded alternative funds that generally do not have the risk characteristics of equity investments. As at December 31, 2008, the Company s allocation to equity securities was approximately 1.0% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 1.7% as at December 31, 2007.

The private investment portfolio is invested in a selection of less liquid private investments that include venture capital, leveraged buy-outs, mezzanine and distressed debt, opportunistic real estate and equity tranches of collateralized debt obligations. As at December 31, 2008 and 2007, the Company s exposure to private investments was approximately $0.4 billion. Included in private investments, at December 31, 2008, are $14.7 million representing equity tranches in unrated pools of collateralized debt obligations. As at December 31, 2008, the Company s exposure to private investments consisted of approximately 1.2% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)), compared to approximately 1.0% as at December 31, 2007.

3) The third component of the Company s total investment portfolio, valued at $0.4 billion at December 31, 2008 and 2007, is related to insurance and financial affiliates and investments in investment management companies. As at December 31, 2008, the Company s allocation to insurance and financial affiliates and investments in investment management companies securities was approximately 1.1% of the total investment portfolio (including cash and cash

equivalents, accrued investment income and net receivable (payable) for investments sold (purchased)) as compared to approximately 0.9% as at December 31, 2007. At December 31, 2008, the Company s investment in insurance affiliates included investments in ARX Holding Corporation and ITAÚ XL Seguros Corporativos S.A., representing operations in the U.S. homeowners insurance and Brazilian commercial insurance markets, respectively. At December 31, 2008, the Company owned minority stakes in nine independent investment management companies. The Company sought to develop relationships with specialty investment management organizations, generally acquiring an equity interest in the business. In these investments, the Company seeks to achieve strong returns on capital while accessing the investment expertise of professionals to help manage portions of the Company s investment assets. In addition, the Company is active in the relationships with these managers, seeking to benefit from the intellectual capital in ways that will enhance the Company s overall financial performance and achieve broader strategic goals.

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

Implementation of investment strategy

Although the Company s management is responsible for implementation of the investment strategy, the day-to-day management of the investment portfolio is outsourced to investment management service providers in accordance with detailed investment guidelines provided and monitored by the Company. This allows the Company an active management of its investment portfolio with flexible access to top talents specializing in various investment products and markets. Managers are selected directly by the Company on the basis of various criteria including investment style, track record, performance, internal controls, operational risk, and diversification implications. Well-established, large institutional investment professionals manage the vast majority of the Company s investment portfolio. Each investment manager may manage one or more portfolios, each of which is governed by a detailed set of investment guidelines, including overall objectives, risk parameters, and diversification requirements that fall within the Company s overall investment policies and guidelines, including but not limited to exposures to eligible securities, prohibited investments/transactions, credit quality and general concentrations limits.

Investment performance

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

Portfolio credit ratings, duration and maturity profile

It is the Company s policy to operate the aggregate fixed income portfolio with a minimum weighted average credit rating of Aa3/AA . The aggregate credit rating is determined based on the weighted average rating of securities, where the average credit rating, where available, from Standard & Poor s (S&P), Moody s Investors Service (Moody s) and Fitch Ratings (Fitch) is allocated to each security. The weighted average credit rating of the fixed income portfolio was AA at December 31, 2008 and 2007.

The Company did not have an aggregate direct investment in a single entity, other than government and sovereign investments, representing debt holdings of the U.S., French and United Kingdom governments, or agency securities representing debt of, excluding mortgages backed by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, in excess of 10% of shareholders equity at December 31, 2008 or 2007.

The aggregate duration and currency of the fixed income portfolio is managed relative to liabilities. Duration measures bond price volatility and is an indicator of the sensitivity of the price of a bond (or a portfolio of bonds) to changes in interest rates, assuming a parallel change in all global yield curves reflecting the percentage change in price for a 100 basis point change in yield. Management believes that the duration of the fixed income portfolio is the best single measure of interest rate risk and the table below summarizes the weighted average duration in years and currency of the main components of the fixed income portfolio at December 31, 2008 and 2007:

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Investment Portfolio Weighted Average Duration in Years	December 31, 2008	December 31, 2007
Fixed income portfolio by Liability Type:		
Property and Casualty General Account	3.2	3.8
Structured and Spread:		
Property and Casualty Structured	4.2	3.3
Other Financial Lines	0.4	0.4
Life Operations	8.9	9.2
Total Fixed income portfolio	4.2	4.3
Fixed income portfolio by Liability Currency:		
U.S. Dollar	3.1	3.1
U.K. Sterling	7.6	7.9
Euro	6.3	5.9
Other	3.4	3.7
Total Fixed income portfolio	4.2	4.3

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

Ratings

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

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

Throughout 2008, various rating agency actions were taken that resulted in downgrades of the financial strength ratings of the Company s leading property and casualty operating companies. During the 2008, the following rating agency actions were taken:

A.M. Best revised the financial strength rating of the Company s lending property and casualty operating companies to A from A+ and affirmed them with a stable outlook.

S&P revised the financial strength rating for the Company s leading property and casualty operating companies to A (Negative) from A+ (Negative).

Moody s Investor Services, Inc. revised the financial strength rating of the Company s principal insurance and reinsurance subsidiaries to A2 (Negative) from A1 (On Review for Possible Downgrade).

Fitch revised the financial strength rating of the Company s leading insurance and reinsurance subsidiaries to A (Rating Watch Negative) from A+ (Rating Watch Negative).

In their public rating action announcements, the rating agencies expressed concerns regarding, among other things, the Company s reduced financial flexibility as a result of significant unrealized losses in the Company s investment portfolio, anticipated weakness in the profitability over the medium term and the belief that the Company s prospective competitive position and resulting underwriting performance have diminished mainly as a result of material earnings and capital charges over the past several years. Notwithstanding these concerns rating agency comments indicate that they are comfortable with the Company s capital position and the quality of the Company s core insurance and reinsurance business.

In addition, during 2008, A.M. Best downgraded the financial strength rating to A (Stable) from A (Stable) and issuer credit rating (ICR) to a (Stable) from a (Stable) of XL Life Ltd.

The following table summarizes the financial strength and claims paying ratings, as noted above, from internationally recognized rating agencies in relation to the Company s principal insurance and reinsurance subsidiaries and pools as at February 27, 2009:

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

In addition, as at February 27, 2009, XL Capital Ltd currently had the following long-term debt ratings: bbb (Stable) from A.M. Best, BBB+ (Negative) from S&P, Baa2 (Negative) from Moody s and BBB+ (Rating Watch Negative) from Fitch.

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

Tax Matters

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

Regulation

The Company s operations are subject to regulation and supervision in each of the jurisdictions where they are domiciled and licensed to conduct business. Generally, regulatory authorities can have broad supervisory and administrative powers over such matters as licenses, fitness of management, standards of solvency, material transactions between affiliates, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of financial statements, reserves for unpaid losses and loss adjustment expenses, reinsurance, minimum capital and surplus requirements and/or risk based capital standards, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. In general, such regulation is for the protection of policyholders rather than shareholders.

Bermuda Operations

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

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

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

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

United States

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

Regulations generally require insurance and reinsurance companies to furnish information to their domestic state insurance department concerning activities that may materially affect the operations, management or financial condition and solvency of the company. Regulations vary from state to state but generally require that each primary insurance company obtain a license from the department of insurance of a state to conduct business in that state. A reinsurance company is not generally required to have an insurance license to reinsure a U.S. ceding company from outside the U.S. However, for a U.S. ceding company to obtain financial statement credit for reinsurance ceded, the reinsurer must obtain an insurance license or accredited status from the cedant s state of domicile or another U.S. state with equivalent insurance regulation or must post collateral to support the liabilities ceded. In addition, regulations for reinsurers vary somewhat from primary insurers in that the form and rate of reinsurance contracts and the market conduct of reinsurers are not subject to regulator approval.

The Company s U.S. insurance subsidiaries are required to file detailed annual and, in most states, quarterly reports with state insurance regulators in each of the states in which they are licensed. Such annual and quarterly reports are required to be prepared on a calendar year basis. In addition, the U.S. insurance subsidiaries operations and accounts are subject to financial condition and market conduct examination at regular intervals by state regulators.

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

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

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

International Operations

A substantial portion of the Company s property and casualty insurance business and a majority of its life reinsurance business is carried on in countries other than Bermuda and the U.S. The degree of regulation in foreign jurisdictions can vary. Generally, the Company s subsidiaries must satisfy local regulatory requirements. Licenses issued by foreign authorities to subsidiaries of the Company are subject to modification or revocation for cause by such authorities. The Company s subsidiaries could be prevented, for cause, from conducting business in certain of the jurisdictions where they currently operate. While each country imposes licensing, solvency, auditing and financial reporting requirements, the type and extent of the requirements differ substantially. Key areas where countries may differ include: (i) the type of financial reports to be filed; (ii) a requirement to use local intermediaries; (iii) the amount of reinsurance permissible; (iv) the scope of any regulation of policy forms and rates; and (v) the type and frequency of regulatory examinations.

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

European Union

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

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

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

Employees

At December 31, 2008, the Company had approximately 4,000 employees. At that date, 394 of the Company s employees were represented by workers councils and 412 of the Company s employees were subject to collective bargaining agreements. Subsequent to December 31, 2008, the Company announced a restructuring initiative which will result in the Company s workforce decreasing by approximately 10% during 2009.

Available Information

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

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

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

The Company adopted Corporate Governance Guidelines, as well as written charters for each of the Audit Committee, the Compensation Committee, the Finance and Risk Oversight Committee, the Nominating and Governance Committee, the Public Affairs Committee as well as a Code of Ethics for Senior Financial Officers, a Code of Business Conduct & Ethics for employees and a related Compliance Program. Each of these documents is posted on the Company s web-site at *http://www.xlcapital.com*, and each is available in print to any shareholder who requests it by writing to the Company at Investor Relations Department, XL Capital Ltd, XL House, One Bermudiana Road, Hamilton HM 11, Bermuda.

The required Section 303A Certification of the Chief Executive Officer of Xl Capital Ltd has been submitted to the New York Stock Exchange, and the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and required by Rules 13a-14(a) of the Securities Exchange Act of 1934, has been filed with the U.S. Securities and Exchange Commission as exhibits to this Annual Report.

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

ITEM 1A. RISK FACTORS

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

Risks Related to the Company

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

As our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies, a further downgrade by any of these institutions could cause our competitive position in the insurance and reinsurance industry to suffer and make it more difficult for us to market our products. As well, the majority of our assumed reinsurance contracts contain provisions that would allow our clients to terminate the contract in the event of a downgrade in our ratings below specified levels by one or more rating agencies. Based on premium value, approximately 65% of our reinsurance contracts that incepted at January 1, 2008 contained provisions allowing clients to terminate those contracts upon a decline in our ratings. A downgrade could also result in a substantial loss of business for us as ceding companies and brokers that place such business may move to other insurers and reinsurers with higher ratings and the loss of key employees.

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

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

In December 2008, S&P lowered counterparty credit and financial strength ratings on XL Capital Ltd s core operating companies to A (negative) from A+ (negative). At the same time, Standard & Poor s lowered its counterparty credit rating on XL Capital Ltd to BBB+ (negative) from A (negative). In addition, during the same period, Moody s revised the financial strength rating of the Company s principal insurance and reinsurance subsidiaries to A2 (Negative) from A1 (On Review for Possible Downgrade) and also revised the counterparty credit rating on XL Capital Ltd to Baa2 (Negative) from Baa1 (On

Review for Possible Downgrade). As well, in December 2008, Fitch revised the financial strength rating of the Company s leading insurance and reinsurance subsidiaries to A (Rating Watch Negative) from A+ (Rating Watch Negative) and also revised the counterparty credit rating on XL Capital Ltd to BBB+ (Rating Watch Negative) from A (Stable).

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

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover our losses. To the extent that the funds generated by our ongoing operations are insufficient to fund future operating requirements and cover claim payments, or that our capital position is adversely impacted by mark-to-market movements on the investment portfolio, catastrophe events or otherwise, we may need to raise additional funds through financings or curtail our growth and reduce our assets. As a result of the current severe economic conditions that persist in the capital markets, any future financing may not be available on terms that are favorable to us, if at all. In addition, any future equity financings could be dilutive to our existing shareholders or could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. Our inability to obtain adequate capital could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

Our assets are invested by a number of professional investment advisory management firms under the direction of our management team in accordance, in general, with detailed investment guidelines set by us. Although our investment policies stress diversification of risks, conservation of principal and liquidity, our investments are subject to market-wide risks, as noted below, and fluctuations, as well as to risks inherent in particular securities.

Our assets are invested by a number of professional investment advisory management firms under the direction of our management team in accordance, in general, with detailed investment guidelines set by us. Although our investment policies stress diversification of risks, conservation of principal and liquidity, our investments are subject to market-wide risks, as noted below, and fluctuations, as well as to risks inherent in particular securities. We are exposed to significant capital markets risk related to changes in interest rates, credit spreads and defaults, market liquidity, equity prices and foreign currency exchange rates. Throughout 2008, financial market conditions continued to be extremely challenging as the global credit crisis that began in July 2007 continued to adversely impact global fixed income markets. Credit spreads on both corporate and structured credit assets widened throughout 2008 and remained wide as at December 31, 2008 as compared to December 31, 2007, resulting in continuing depressed pricing on fixed income securities and other credit products. If significant, continued volatility, changes in interest rates, changes in credit spreads and defaults, a lack of pricing transparency, market liquidity, declines in equity prices, and the strengthening or weakening of foreign currencies against the U.S. dollar, individually or in tandem, could have a material adverse effect on our consolidated results of operations, financial condition or cash flows through realized losses, impairments, and changes in unrealized positions. Levels of write-down or impairment are impacted by our assessment of the intent and ability to hold securities which have declined in value until recovery as well as actual losses as a result of defaults or cash-flow deterioration. We periodically review our investment portfolio structure and strategy. If, as a result of such review, we determine to reposition or realign portions of the portfolio where we determine not to hold certain securities in an unrealized loss position to recovery, then we will incur an other than temporary impairment charge. Such charges may have a material adverse effect on our results of operations and business.

During 2008, the prolonged and severe disruptions in the public debt and equity markets, including among other things, widening of credit spreads, bankruptcies and government intervention in a number of large financial institutions, have resulted in significant realized and unrealized losses in our investment portfolio. For the year ended December 31, 2008, we incurred substantial realized and unrealized investment losses, as described in Management s Discussion and Analysis of Financial Condition and Results of Operations under Part II, Item 7 of this report. We continue to closely monitor current market conditions and evaluate the long term impact of this recent market volatility on all of our investment holdings. Depending on market conditions, we could incur additional realized and unrealized losses in future periods, which could have a material adverse effect on the Company s results of operations, financial condition and business.

Our exposure to interest rate risk relates primarily to the market price and cash flow variability associated with changes in interest rates. Our investment portfolio contains interest rate sensitive instruments, such as fixed income securities, which have been and may continue to be adversely affected by changes in interest rates from governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. A rise in interest rates would increase the net unrealized loss position of our investment portfolio, offset by our ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would decrease the net unrealized loss position of our investment portfolio, offset by lower rates of return on funds reinvested. Our mitigation efforts with respect to interest rate risk are primarily focused towards maintaining an investment portfolio with diversified maturities that has a weighted average duration that is approximately equal to the duration of our estimated liability cash flow profile. However, our estimate of the liability cash flow profile may be inaccurate and we may be forced to liquidate investments prior to maturity at a loss in order to cover liabilities. Although we take measures to manage the economic risks of investing in a changing interest rate environment, we may not be able to mitigate the interest rate risk of our assets relative to our liabilities.

A portion of our risk asset portfolio consists of below investment-grade high yield fixed income securities, a portion of which are non-investment grade as a result of recent credit downgrades. These securities have a higher degree of credit or default risk. Certain sectors within the investment and below investment grade fixed income market, such as structured and corporate credit, may be less liquid in times of economic weakness or market disruptions. While we have put in place procedures to monitor the credit risk and liquidity of our invested assets, in general and those impacted by recent credit market issues specifically, it is possible that, in periods of economic weakness or periods of turmoil in capital markets, we may experience default losses in both our investment-grade and below investment-grade corporate and structured credit holdings. This may result in a material reduction of net income, capital and cash flows. Beginning in the latter half of 2007 and continuing throughout 2008, increasing delinquencies in U.S. residential collateral in various securitized products has led to increased volatility and decreased liquidity across financial markets as a whole. Decreases in market liquidity have increased the difficulty and volatility in pricing across credit exposed markets. Such illiquidity, volatility and related uncertainty may persist or even worsen in the future.

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

Our functional currencies of our principal insurance and reinsurance subsidiaries include the U.S. dollar, U.K. sterling, the Euro, the Swiss Franc, and the Canadian dollar. Exchange rate fluctuations relative to the functional currencies may materially impact our financial position and results of operations. Many of our non- U.S. subsidiaries maintain both assets and liabilities in currencies different than their functional currency, which exposes us to changes in currency exchange rates.

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

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

We hold certain investments that may lack liquidity or of which the observability of prices or inputs may be reduced in periods of market dislocation, such as sub-prime non-agency securities, second liens, ABS CDOs with sub-prime collateral as well as Alt-A mortgage exposures. Even some of our high quality assets have been more illiquid as a result of the recent challenging market conditions. Generally, securities classified as Level 3 pursuant to the fair value hierarchy set forth in FAS 157 may be less liquid, more difficult to value and require significant judgment, and more likely to result in sales materially different than fair values determined by management.

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

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

Changes to U.S. GAAP with respect to whether unrealized losses on hybrid securities are other than temporary impairments may result in additional impairment charges

Recent correspondence between the SEC and FASB indicates that the application of the impairment model specified for debt securities remains the appropriate basis for analyzing investment grade hybrid securities for other than temporary impairments. However, should accounting standards require the application of the model specified for equity securities, where the primary determinant of charges for other than temporary impairments is the duration of impairments, we would be required to re-evaluate our assertion that unrealized losses on such hybrid securities are considered temporary, which could materially and negatively impact future results.

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

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

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

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

We own a number of Tier 1 and 2 hybrid securities issued by financial institutions including those based in the U.S. and U.K. There is a risk that if markets continue to deteriorate, that further government intervention, particularly nationalization of such institutions, could occur. There is also a risk of regulatorily imposed deferral of coupons. This may result in losses on the hybrid securities we hold.

There can be no assurance as to the effect that any such governmental actions or future regulatory initiatives may have on certain investment instruments in our investment portfolio, or on our competitive position, business and financial position.

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

Our results of operations and financial condition depend upon our ability to assess accurately the potential losses associated with the risks that we insure and reinsure. We establish reserves for unpaid losses and loss adjustment expense (LAE) liabilities, which are estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. The process of establishing reserves for property and casualty claims can be complex and is subject to considerable variability as it requires the use of informed estimates and judgments. Actuarial estimates of unpaid loss and LAE liabilities are subject to potential errors of estimation, which could be significant, due to the fact that the ultimate disposition of claims incurred prior to the date of such estimation, whether reported or not, is subject to the outcome of events that have not yet occurred. Examples of these events include the accuracy of the factual information on which the estimates were based, especially as this develops, jury decisions, court interpretations, legislative changes, changes in the medical condition of claimants, public attitudes, and economic conditions such as inflation. Any estimate of future costs is subject to the inherent limitation on the ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of loss and LAE liabilities will vary, perhaps materially, from any estimate.

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

In relation to previously written financial guarantee business and related exposures, we establish reserves for losses and LAE on such business based on management s best estimate of the ultimate expected incurred losses. Our estimated ultimate expected incurred losses are comprised of: (i) case basis reserves, (ii) unallocated reserves, and (iii) cumulative paid losses to date. Establishment of such reserves requires the use and exercise of significant judgment by management, including with respect to estimates regarding the occurrence and amount of a loss on an insured or reinsured obligation. Estimates of losses may differ from actual results and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred. Examples of these events include changes in the level of interest rates, credit deterioration of insured and reinsured obligations, and changes in the value of specific assets supporting insured and reinsured obligations. In general, guarantees in credit default swap form previously written are exposed to the same risks as noted above, except in events of default by the guarantor. Credit default swaps, however, do not qualify for the financial guarantee scope exception under FAS 133, and, therefore are reported at fair value with changes in the fair value included in earnings. Fair value for such swaps are determined based on methodologies further described in Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates under Item II, Part 7 of this report. Any estimate of future costs is subject to the inherent limitation on our ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and LAE will vary, perhaps materially, from any estimate.

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

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

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

The occurrence of disasters could adversely affect our financial condition.

We have substantial exposure to losses resulting from natural and man-made disasters and other catastrophic events. Catastrophes can be caused by various events, including hurricanes, earthquakes, floods, hailstorms, explosions, severe weather, fires, war and acts of terrorism. The incidence and severity of catastrophes are inherently unpredictable, and it is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss any given occurrence will generate.

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

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

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

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

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

In fiscal 2008, the market price of our Class A ordinary shares declined very significantly during the year. A substantial portion of our annual compensation paid to our senior employees has, in recent years, been paid in the form of equity-based awards. In addition, we reduced the number of employees across nearly all of our locations in August 2008 as well as in February 2009. The combination of these events could adversely affect our ability to hire, motivate and retain qualified employees.

In addition, many of our senior executives working in Bermuda are not Bermudian and our success may depend in part on the continued services of key employees in Bermuda. Under Bermuda law, non-Bermudians (other than spouses of Bermudians and holders of permanent resident certificates) may not engage in any gainful occupation in

Bermuda without an appropriate governmental work permit. A work permit may be granted or renewed by the Bermuda government for a specific period of time, upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian or holder of a permanent resident certificate) is available who meets the minimum standards reasonably required by an employer with respect to a certain position. The government of Bermuda places a six-year term limit on individuals with work permits, subject to certain exemptions for key employees. No assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term or that key employee status will be granted or revoked.

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

Following the goodwill impairment charge of $990.0 million recorded during the fourth quarter of 2008, the goodwill balance at December 31, 2008 was $813.3 million. When we acquire an entity, the excess of the purchase price over the net identifiable assets acquired is allocated to goodwill. We conduct impairment tests on our reported goodwill at least annually or more frequently if impairment indicators exist. In performing a goodwill impairment test, we use various methods and make various assumptions to determine the fair value of our reporting units, including the determination of expected future cash flows and/or profitability of such reporting units, and we take into account market value multiples and/or cash flows of entities that we deem to be comparable in nature, scope or size to our reporting units. However, expected future cash flows and/or profitability may be materially and negatively impacted as a result of, among other things, a decrease in renewal activity and new business opportunities, retaining our underwriting teams, lower-than-expected yields and/or cash flows from our investment portfolio, higher-than-expected claims activity and magnitude of incurred losses and general economic factors that impact the reporting unit. In addition, previously determined market value multiples and/or cash flows may no longer be relevant as a result of these potential factors. As a result of these potential changes, the estimated fair value of one or more of our reporting units may decrease, causing the carrying value of the net assets assigned to the reporting unit to exceed the fair value of such net assets. If we determine an impairment exists, we adjust the carrying value of goodwill to its implied fair value. The impairment charge is recorded in our income statement in the period in which the impairment is determined. If we are required in the future to write down additional goodwill, our financial condition and results of operations would be negatively affected. In connection with fair value measurements and the accounting for goodwill, the use of generally accepted accounting principles requires management to make certain estimates and assumptions. Significant judgment is required in making these estimates and assumptions, and actual results may ultimately be materially different from such estimates and assumptions.

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

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

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

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

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

Following the closing of the Master Agreement, Syncora and its applicable subsidiaries are required to use commercially reasonable efforts to commute the underlying financial guarantees that are the subject of the EIB Guarantees. There can be no assurances that such commutation will ultimately occur and that our $955.4 million exposure (as of December 31, 2008) under the EIB Guarantees will be eliminated.

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

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

intended to hinder, delay or defraud its creditors; or

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

was insolvent or rendered

insolvent by reason of such incurrence; or

was engaged in a business or transaction for which its remaining assets constituted unreasonably small capital; or

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

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

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

Since the closing of the Master Agreement, Syncora has stated in its quarterly reports on Form 10-Q for the quarters ended June 30, 2008 and September 30, 2008, that substantial doubt exists as to their ability to continue as a going concern. In addition, Syncora was delisted from the New York Stock Exchange (the NYSE) as a result of its common shares no longer meeting the NYSE continued listing standards.

Current legal and regulatory activities relating to insurance brokers and agents, contingent commissions, the municipal guaranteed investment contract market could adversely affect our business, financial condition and results of operations.

In 2004 contingent commission arrangements became a focus of investigations by various regulatory agencies, including certain state Attorneys General and insurance departments. Due to various governmental investigations into contingent commission practices, various market participants have modified or eliminated acquisition expenses formerly arising from placement service agreements and related arrangements. As a result, it is possible that policy commissions or brokerage that we pay may increase in the future and/or that different forms of broker or prodcer compensation arrangements will develop in the future. Any such additional expense that may result could have a material adverse effect on our financial conditions or results.

One of our subsidiaries that had been a provider of municipal guaranteed investment contracts (GICs) received a grand jury subpoena in November 2006 from the Antitrust Division of the U.S. Department of Justice (the DOJ) and a subpoena from the SEC seeking documents pursuant to respective investigations into municipal GICs and related products sold in connection with municipal bond offerings. Our subsidiary is fully cooperating with these federal industry-wide investigations. In June 2008, subsidiaries of ours also received a subpoena from the Office of the Connecticut Attorney General and an Antitrust Civil Investigative Demand from the Office of the Florida Attorney General in connection with a coordinated multi-state Attorneys General investigation into the matters referenced in the DOJ and SEC subpoenas. We are fully cooperating with these investigations.

At this time, we are unable to predict the potential effects, if any, that these investigations may have upon us, the insurance and reinsurance markets in general or industry and reinsurance business practices or what changes, if any, may be made to laws and regulations regarding the industry. Any of the foregoing could also result in litigation or otherwise adversely affect our business, financial condition, or results of operations.

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

We purchase reinsurance for our own account in order to mitigate the volatility that losses impose on our financial condition. Our clients purchase reinsurance from us to cover part of the risk originally written by them. Retrocessional reinsurance involves a reinsurer ceding to another reinsurer, the retrocessionaire, all or part of the reinsurance that the first reinsurer has assumed. Reinsurance, including retrocessional reinsurance, does not legally discharge the ceding company from its liability with respect to its obligations to its insureds or reinsureds. A reinsurer s or retrocessionaire s insolvency, inability or refusal to make timely payments under the terms of its agreements with us, therefore, could have a material adverse effect on us because we remain liable to our insureds and reinsureds. At December 31, 2008, we had approximately $4.6 billion of reinsurance recoverables and reinsurance balances receivable, net of reserves for uncollectible recoverables. For further information regarding our reinsurance exposure, see Management s Discussion and Analysis of Financial Condition and Results of Operations , under Part II, Item 7 of this report.

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

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

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

Operational risk and losses can result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, or external events.

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

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

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

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

We market our insurance and reinsurance products worldwide primarily through insurance and reinsurance brokers. Marsh & McLennan Companies and AON Corporation and their respective subsidiaries each provided approximately 17%, of our gross written premiums for property and casualty operations for the year ended December 31, 2008. Loss of all or a substantial portion of the business provided by one or more of these brokers could have a material adverse effect on our business.

Our reliance on brokers subjects us to credit risk.

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

Risks Related to the Insurance and Reinsurance Industries

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

The insurance and reinsurance industries have historically been cyclical, characterized by periods of intense price competition due to excess underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. An increase in premium levels is often offset by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Either of these factors could lead to a significant reduction in premium rates, less favorable policy terms and conditions and fewer submissions for our underwriting services. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the insurance and reinsurance industries significantly. Throughout most of 2008, both the insurance and reinsurance industries experienced soft market conditions, including decreases in premium rates across most lines of business, increased competitive pressures and increased retention by insureds and/or cedants. While pricing relative to risks in such markets began to improve in late 2008 and early 2009, there is no assurance that such improvements in rates and conditions will continue.

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

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

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

In response to the tightening of supply in certain insurance and reinsurance markets resulting from, among other things, the September 11 event, the Terrorism Risk Insurance Program (TRIP) was created upon the enactment of the U.S. Terrorism Risk Insurance Act of 2002 (TRIA) to ensure the availability of commercial insurance coverage for certain terrorist acts in the U.S. This law established a federal assistance program through the end of 2005 to help the commercial property and casualty insurance industry cover claims related to future terrorism-related losses and required that coverage for terrorist acts be offered by insurers. TRIA was originally scheduled to expire at the end of 2005, but was extended in December 2005 for an additional two years. On December 26, 2007, President George Bush approved the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA), extending TRIP through December 31, 2014 and also eliminated the distinction between foreign and domestic acts of terrorism.

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

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

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

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

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

- requiring our participation in industry pools and guarantee associations;

- expanding the scope of coverage under existing policies;

- regulating the terms of

insurance and reinsurance policies; or

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

The insurance industry is also affected by political, judicial and legal developments that may create new and expanded theories of liability, which may result in unexpected claims frequency and severity and delays or cancellations of products and services by insureds, insurers and reinsurers which could adversely affect our business.

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

Consolidation in the insurance industry could adversely impact us.

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

Risks Related to Regulation

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

Our insurance and reinsurance subsidiaries operate in 28 countries around the world as well as in all 50 U.S. states. Our operations in each of these jurisdictions are subject to varying degrees of regulation and supervision. The laws and regulations of the jurisdictions in which our insurance and reinsurance subsidiaries are domiciled require, among other things, that these subsidiaries maintain minimum levels of statutory capital, surplus and liquidity, meet solvency standards, submit to periodic examinations of their financial condition and restrict payments of dividends and reductions of capital. Statutes, regulations and policies that our insurance and reinsurance subsidiaries are subject to may also restrict the ability of these subsidiaries to write insurance and reinsurance policies, make certain investments and distribute funds.

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

We may not be able to comply fully with, or obtain desired exemptions from, revised statutes, regulations and policies that govern the conduct of our business. Failure to comply with, or to obtain desired authorizations and/or exemptions under, any applicable laws could result in restrictions on our ability to do business or undertake activities that are regulated in one or more of the jurisdictions in which we operate and could subject us to fines and other sanctions. In addition, changes in the laws or regulations to which our insurance and reinsurance subsidiaries are subject, or in the interpretations thereof by enforcement or regulatory agencies, could have a material adverse effect on our business.

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

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

maintain a minimum level of capital and surplus;

maintain solvency margins and liquidity ratios;

restrict dividends and distributions;

obtain prior approval regarding the ownership and transfer of shares;

maintain a principal

office and appoint and maintain a principal representative in Bermuda;

file an annual statutory financial return;

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

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

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

financial
conditions.

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

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

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

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

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

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

Risks Related to Taxation

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

We take the position that neither we nor any of our Bermuda insurance subsidiaries are engaged in a U.S. trade or business through a U.S. permanent establishment. Accordingly, we take the position that none of our Bermuda insurance subsidiaries should be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income). However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the United States, we cannot be certain that the U.S. Internal Revenue Service (the IRS) will not contend successfully that we or any of our Bermuda insurance subsidiaries are engaged in a trade or business in the United States. If we or any of our Bermuda insurance subsidiaries were considered to be engaged in a trade or business in the United States, any such entity could be subject to U.S. corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business, in which case our financial condition and results of operations could be materially adversely affected.

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

The tax treatment of non-U.S. companies and their U.S. and non-U.S. insurance subsidiaries has been the subject of Congressional discussion and legislative proposals. For example, one legislative proposal would impose additional limits on the deductibility of interest by foreign-owned U.S. corporations. Another legislative proposal would treat a non-U.S. corporation as a U.S. corporation for U.S. federal income tax purposes if it were considered to be primarily managed and controlled in the U.S. In addition, in 2008, legislation was proposed in the U.S. that would severely restrict the ability of a company to utilize affiliate reinsurance to manage its U.S. risks and capital position. In general, the legislation (the Neal Bill proposed in the House of Representatives and a Senate Finance Draft release) would permanently disallow the deduction for premiums ceded to affiliates, to the extent the reinsurance exceeded industry aggregate levels of unrelated party reinsurance, calculated on a statutory line of business basis. If enacted, any such law could have an adverse impact on us or our shareholders. It is possible that other legislative proposals could emerge in the future that could also have an adverse impact on us or our shareholders. We cannot assure you that future legislative action will not increase the amount of U.S. tax payable by us. If this happens, our financial condition and results of operations could be materially adversely affected.

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

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

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

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

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

The OECD has undertaken to implement the conclusions of the Report in two phases. First, to provide improved certainty for the interpretation of existing treaties based on the current text of Article 7, the OECD has revised the commentary to the current version of Article 7 to take into account the conclusions of the Report that do not conflict with the existing interpretation of Article 7 reflected in the previous commentary. Second, to reflect the full conclusions of the Report, the OECD intends to issue a new version of Article 7 and related commentary to be used in the negotiation of new treaties and amendments to existing treaties. A discussion draft of the new Article 7 and related commentary was released on July 7, 2008, and the final version of this new Article 7 is expected to be released in 2010. The final version of new Article 7 might include provisions that could change the manner in which we are taxed.

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

Under certain circumstances, a U.S. person who owns 10% or more of the voting power of a foreign corporation that is a CFC (a foreign corporation in which 10% U.S. shareholders own more than 50% of the voting power of the foreign corporation or more than 25% of a foreign insurance company) for an uninterrupted period of 30 days or more during a taxable year must include in gross income for U.S. federal income tax purposes such 10% U.S. Shareholder s pro rata share of the CFC s subpart F income, even if the subpart F income is not distributed to such 10% U.S. Shareholder, if such 10% U.S.

Shareholder owns (directly or indirectly through foreign entities) any shares of the foreign corporation on the last day of the corporation s taxable year. Subpart F income of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income) attributable to the insurance of risks situated outside the CFC s country of incorporation. Ownership of our equity security units by a U.S. person may cause such person to be treated for U.S. federal income tax purposes as the owner of our ordinary shares prior to the purchase contract settlement date. For purposes of interpreting the voting restrictions in our Articles of Association, we intend to treat the ordinary shares issuable upon settlement of a purchase contract underlying a unit as currently owned by the holder of that unit.

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

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

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

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

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

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

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

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

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

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

Risks Related to our Ordinary Shares

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

Our Articles of Association generally provide that shareholders have one vote for each ordinary share held by them and are entitled to vote, on a non-cumulative basis, at all meetings of shareholders. However, the voting rights exercisable by a shareholder may be limited so that certain persons or groups are not deemed to hold 10% or more of the voting power conferred by our ordinary shares. Under these limitations, some shareholders may have less than one vote for each ordinary share held by them. Moreover, these limitations could have the effect of reducing the voting power of some shareholders who would not otherwise be subject to such limitations by virtue of their direct share ownership.

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

Our Articles of Association provide that our Board of Directors shall decline to register a transfer of shares if it appears to our Board of Directors, whether before or after such transfer, that the effect of such transfer would be to increase the number of shares owned or controlled by any person to 10% or more of any class of voting shares, the total issued shares of XL Capital Ltd or the voting power of XL Capital Ltd. In addition, our Articles of Association also provide that if, and for so long as, the votes conferred on any person by the ownership or control of our shares (including any preference ordinary shares) constitute 10% or more of the votes conferred by our issued shares, each such share held by such person shall confer only a fraction of the vote that would otherwise be conferred, as determined by the formula described in our Articles of Association, and such voting rights will continue to be readjusted until no shareholder s voting rights exceed this limitation as a result of such reduction. Notwithstanding the foregoing, our Board of Directors may make such final adjustments to the aggregate number of votes conferred on any person by the ownership or control of shares that they consider fair and reasonable, in the light of all applicable circumstances, to ensure that such votes represent less than 10% of the aggregate voting power of the votes conferred by all our issued shares. For these purposes, references to ownership or control of our shares mean ownership within the meaning of Section 958 of the Code and Section 13(d)(3) of the Securities Exchange Act of 1934, as amended.

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

Our Articles of Association contain provisions that may make it more difficult for shareholders to replace directors and could delay or prevent a change of control that a shareholder may consider favorable. These provisions include a staggered board of directors, limitations on the ability of shareholders to remove directors, limitations on voting rights and certain transfer restrictions on our ordinary shares. See Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, under Part II, Item 5 of this report. In addition, insurance regulations in certain jurisdictions may also delay or prevent a change of control or limit the ability of a shareholder to acquire in excess of specified amounts of our ordinary shares.

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

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

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

original actions brought in the Cayman Islands against these persons or XL Capital Ltd predicated solely upon U.S. federal securities laws.

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

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

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

Future sales of shares of our ordinary shares, including ordinary shares held by Syncora in connection with the Master Agreement, may depress the price of our ordinary shares.

Any sales of a substantial number of ordinary shares including ordinary shares held by Syncora in connection with the Master Agreement, or the perception that those sales might occur, may cause the market price of our ordinary shares to decline.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company operates in Bermuda, the United States, Europe and various other locations around the world. In 1997, the Company acquired commercial real estate in Hamilton, Bermuda for the purpose of securing long-term office space for its worldwide headquarters. The development was completed in April 2001. The total cost of this development, including land, was approximately $126.6 million.

In July 2003, the Company acquired new offices at 70 Gracechurch Street, London, which have become the Company s new London headquarters. The acquisition was made through a purchase, sale and leaseback transaction. The move to the new offices was completed in 2004 and consolidated the Company s London businesses in one location. The capital lease asset and liability associated with this transaction totaled $129.3 million at December 31, 2008.

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

Total rent expense for the years ended December 31, 2008, 2007 and 2006 was $35.4 million, $34.5 million and $35.8 million, respectively. See Item 8, Note 20(d) to the Consolidated Financial Statements, Commitments and Contingencies Properties, for discussion of the Company s lease commitments for real property.

ITEM 3. LEGAL PROCEEDINGS

On September 21, 2004, a consolidated and amended class action complaint (the Amended Complaint) was served on the Company and certain of its present and former directors and officers as defendants in a putative class action (Malin et al. v. XL Capital Ltd et al.) filed in United States District Court, District of Connecticut (the Malin Action). The Malin Action purports to be on behalf of purchasers of the Company s common stock between November 1, 2001 and October 16, 2003, and alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder (the Securities Laws). The Amended Complaint alleged that the defendants violated the Securities Laws by, among other things, failing to disclose in various public statements, reports to shareholders and other communications the alleged inadequacy of the Company s loss reserves for its NAC Re subsidiary (now known as XL Reinsurance America, Inc.) and that, as a consequence, the Company s earnings and assets were materially overstated. On August 26, 2005, the Court dismissed the Amended Complaint owing to its failure adequately to allege that the lead plaintiffs had sustained a loss, but provided leave for the plaintiffs to file a further amended complaint. The plaintiffs thereafter filed another amended complaint (the Second Amended Complaint), which is similar to the Amended Complaint in its substantive allegations. By order dated July 21, 2007, the Judge granted defendants motion to dismiss the Second Amended Complaint and plaintiffs appealed the dismissal order. By order dated February 26, 2009, the U.S. Court of Appeals for the Second Circuit affirmed the decision of the District Court.

In November 2006, a subsidiary of the Company received a grand jury subpoena from the Antitrust Division of the U.S. Department of Justice (DOJ) and a subpoena from the SEC, both of which sought documents in connection with an investigation into the municipal guaranteed investment contract (GIC) market and related products. In June 2008, subsidiaries of the Company also received a subpoena from the Connecticut Attorney General and an Antitrust Civil Investigative Demand from the Office of the Florida

Attorney General in connection with a coordinated multi-state Attorneys General investigation into the matters referenced in the DOJ and SEC subpoenas. The Company is fully cooperating with these investigations.

Commencing in March 2008, the Company and two of its subsidiaries were named, along with approximately 20 other providers and insurers of municipal Guaranteed Investment Contracts and similar derivative products in the U.S. (collectively Municipal Derivatives) as well as fourteen brokers of such products, in several purported federal antitrust class actions. The Judicial Panel on Multidistrict Litigation ordered that these be consolidated for pretrial purposes and assigned them to the Southern District of New York. The consolidated amended complaint filed in August 2008 alleges that there was a conspiracy among the defendants during the period from January 1, 1992 to the present to rig bids and otherwise unlawfully decrease the yield for Municipal Derivative products. The purported class of plaintiffs consists of purchasers of Municipal Derivatives. On October 21, 2008 most of the defendants filed motions to dismiss the consolidated amended complaint, which motions were fully briefed as of January 21, 2009. In addition, the same two subsidiaries of the Company have been named in a number of similar actions filed by various municipalities in California state courts. The Defendants have removed those cases to federal court. The Plaintiffs have filed motions to remand, most of which have been denied but some of which remain pending. Certain of the cases originally filed in California state courts have been transferred to the Southern District of New York by the Judicial Panel on Multidistrict Litigation. The Company intends to vigorously defend these actions.

From time to time, the Company has also received and responded to additional requests from Attorneys General, state insurance regulators and federal regulators for information relating to the Company s contingent commission arrangements with brokers and agents and/or the Company s insurance and reinsurance practices in connection with certain finite-risk and loss mitigation products. Similarly, the Company s affiliates outside the U.S. have, from time to time, received and responded to requests from regulators relating to the Company s insurance and reinsurance practices regarding contingent commissions or finite-risk and loss mitigation products. The Company has fully cooperated with the regulators in these matters.

In August 2005, plaintiffs in a proposed class action (the Class Action) that was consolidated into a multidistrict litigation in the United States District Court for the District of New Jersey, captioned In re Insurance Brokerage Antitrust Litigation, MDL No. 1663, Civil Action No. 04-5184 (the MDL), filed a consolidated amended complaint (the Amended Complaint), which named as new defendants approximately 30 entities, including Greenwich Insurance Company, Indian Harbor Insurance Company and XL Capital Ltd. In the MDL, the Class Action plaintiffs asserted various claims purportedly on behalf of a class of commercial insureds against approximately 113 insurance companies and insurance brokers through which the named plaintiffs allegedly purchased insurance. The Amended Complaint alleged that the defendant insurance companies and insurance brokers conspired to manipulate bidding practices for insurance policies in certain insurance lines and failed to disclose certain commission arrangements and asserted statutory claims under the Sherman Act, various state antitrust laws and the Racketeer Influenced and Corrupt Organizations Act (RICO), as well as common law claims alleging breach of fiduciary duty, aiding and abetting a breach of fiduciary duty and unjust enrichment. By Opinion and Order dated August 31, 2007, the Court dismissed the Sherman Act claims with prejudice and, by Opinion and Order dated September 28, 2007, the Court dismissed the RICO claims with prejudice. The plaintiffs then appealed both orders to the U.S. Court of Appeals for the Third Circuit. Oral argument before the appellate court is expected in April 2009.

Various XL entities have been named as defendants in three of the many tag-along actions that have been consolidated into the MDL for pretrial purposes. These tag-along actions make allegations similar to the Amended Complaint but do not purport to be class actions. On April 4, 2006, a tag-along Complaint was filed in the U.S. District Court for the Northern District of Georgia on behalf of New Cingular Wireless Headquarters LLC and several other corporations against approximately 100 defendants, including Greenwich Insurance Company, XL Specialty Insurance Company, XL Insurance America, Inc., XL Insurance Company Limited, Lloyd s syndicates 861, 588 and 1209 and XL Capital Ltd. (the New Cingular Lawsuit). On or about May 21, 2007, a tag-along Complaint was filed in the U.S. District Court for the District of New Jersey on behalf of Henley Management Company, Big Bear Properties, Inc., Northbrook Properties, Inc., RCK Properties, Inc., Kitchens, Inc., Aberfeldy LP and Payroll and Insurance

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Group, Inc. against multiple defendants, including XL Winterthur International (the Henley Lawsuit). On October 12, 2007, a Complaint in a third tag-along action, captioned Sears Roebuck & Co. v. Marsh & McLennan Companies, Inc., et al., No. 1:07-CV-2535 (the Sears Lawsuit), was filed in the U.S. District Court for the Northern District of Georgia by Sears, Roebuck & Co., Sears Holdings Corporation, Kmart Corporation and Lands End Inc. Among the many named defendants are X.L. America, Inc., XL Insurance America, Inc., XL Specialty Insurance Company and XL Insurance (Bermuda) Ltd. The three tag-along actions are currently stayed.

Three purported class actions on behalf of shareholders of Syncora have been filed in the Southern District of New York against the Company and one of its subsidiaries (collectively XL), Syncora, four Syncora officers, and various underwriters of Syncora securities. The Judge ordered that these be consolidated. The consolidated amended complaint, filed in August 2008, alleges violations of the Securities Act of 1933 arising out of the secondary public offering of Syncora common shares held by XL on June 6, 2007 and sales/exchanges by Syncora of certain preferred shares as well as under the Securities Exchange Act of 1934 arising out of trading in Syncora securities during the asserted class period of March 15, 2007 to March 17, 2008. The principal allegations are that Syncora failed to appropriately and timely disclose its exposures under certain derivative contracts and insurance of tranches of structured securities. XL is named as a party that controlled Syncora during the relevant time period. On October 14, 2008, XL and other defendants filed motions to dismiss the consolidated amended complaint. Plaintiffs filed opposition briefs on December 22, 2008, and XL and the other defendants filed reply briefs on February 5, 2009. The Company intends to vigorously defend these actions.

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

The Company is subject to litigation and arbitration in the normal course of its business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company s loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to litigation relating to insurance and reinsurance claims, the Company and its subsidiaries are subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on insurance or reinsurance policies. This category of business litigation typically involves, amongst other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes or disputes arising from business ventures. The status of these legal actions is actively monitored by management. If management believed, based on available information, that an adverse outcome upon resolution of a given legal action was probable and the amount of that adverse outcome was reasonable to estimate, a loss would be recognized and a related liability recorded. The Company believes that the expected ultimate outcome of all outstanding litigation and arbitration will not have a material adverse effect on its consolidated financial condition, operating results and/or liquidity, although an adverse resolution of one or more of these items could have a material adverse effect on the Company s results of operations in a particular fiscal quarter or year.

For further information in relation to legal proceedings, see Item 8, Note 20 (g) to the Consolidated Financial Statements, Commitments and Contingencies Claims and Other Litigation.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of ordinary shareholders during the fourth quarter of the fiscal year covered by this report.

Executive Officers of the Company

The table below sets forth the names, ages and titles of the persons who were the executive officers of the Company at December 31, 2008:

Name	Age	Position
Michael S. McGavick	51	Chief Executive Officer and Director
Brian W. Nocco	56	Executive Vice President and Chief Financial Officer
James H. Veghte	52	Executive Vice President and Chief Executive of Reinsurance Operations
David B. Duclos	51	Executive Vice President and Chief Executive of Insurance Operations
Sarah E. Street	46	Executive Vice President and Chief Investment Officer
Kirstin Romann Gould	42	Executive Vice President, General Counsel and Secretary
Susan L. Cross	48	Executive Vice President and Global Chief Actuary
Celia R. Brown	54	Executive Vice President, Head of Global Human Resources and Corporate Relations
Jacob D. Rosengarten	53	Executive Vice President and Chief Enterprise Risk Officer

Michael S. McGavick, was appointed as Director of the Company in April 2008 and shortly prior to his commencement as the Company s Chief Executive Officer on May 1, 2008. Previously, Mr. McGavick was President, Chairman (2002-2005) & CEO of the Seattle-based Safeco Corporation from January 2001 to December 2005. Prior to joining Safeco, Mr. McGavick spent six years with the Chicago-based CNA Financial Corporation, where he held various senior executive positions before becoming President and Chief Operating Officer of the company s largest commercial insurance operating unit. Mr. McGavick s insurance industry experience also includes two years as Director of the American Insurance Association s Superfund Improvement Project in Washington D.C. where he became the Association s lead strategist in working to transform U.S. Superfund environmental laws.

Brian W. Nocco was appointed Executive Vice President, Chief Financial Officer in August 2007. Mr. Nocco was previously employed at Nationwide Insurance Group as Chief Risk Officer from 2006 to 2007, and Senior Vice President and Treasurer from 2001 to 2005. Prior to Nationwide, Mr. Nocco served as Executive Vice President, Corporate Development of Imperial Bank and Chief Financial Officer of two of its subsidiaries. From 1994 to 1998, Mr. Nocco served as Senior Vice President, Chief Compliance Officer with The Chubb Corporation.

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

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

Sarah E. Street was appointed to the position of Executive Vice President and Chief Investment Officer in October 2006. Ms. Street is also the Chief Executive Officer of XL Capital Investment Partners. Prior to joining XL, Ms.

Street held numerous leadership positions at JPMorganChase and its predecessor organizations, working in a number of corporate finance units as well as in the capital markets business of the bank.

Kirstin Romann Gould was appointed to the position of Executive Vice President, General Counsel in September 2007 and this position includes her prior responsibilities as General Counsel, Corporate Affairs and Corporate Secretary. Ms. Gould was previously Executive Vice President, General Counsel, Corporate

Affairs from July 2006 to September 2007 and has also served as Chief Corporate Legal Officer and Associate General Counsel. Prior to joining the Company, Ms. Gould was associated with the law firms of Clifford Chance and Dewey Ballantine in New York and London.

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

Celia R. Brown was appointed to the Company s senior leadership team in February 2008, serving as Executive Vice President, Head of Global Human Resources and Corporate Relations, where she is responsible for human relations, marketing, global communications, public relations and corporate social responsibility. Ms. Brown has served as Head of Global Human Resources and Corporate Relations since 2006 and previously was the lead for Global Human Resources Operations from 2004 to 2006. Ms. Brown has spent over twenty years with the Company and its subsidiaries, including its predecessor companies, in capacities including Associate General Counsel, Corporate Secretary and Head of Human Resources for NAC Re Corp and Chief Administrative Officer for X.L. America and for the Company s Insurance Operations.

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

PART II

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

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

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

	High	Low	Close
2008:			
1st Quarter	$ 52.26	$ 27.73	$ 29.55
2nd Quarter	38.30	20.33	20.56
3rd Quarter	23.60	13.50	17.94
4th Quarter	17.94	2.65	3.70
2007:			
1st Quarter	$ 74.40	$ 66.93	$ 69.96
2nd Quarter	84.91	69.44	84.29
3rd Quarter	85.67	70.47	79.20
4th Quarter	82.10	48.16	50.31

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

The number of record holders of Class A ordinary shares as of December 31, 2008 was 373. This figure does not represent the actual number of beneficial owners of the Company s Class A ordinary shares because such shares are frequently held in street name by securities dealers and others for the benefit of individual owners who may vote the shares.

In 2008, two quarterly dividends of $0.38 per share were paid to all ordinary shareholders of record as of March 14 and June 13 and two quarterly dividends of $0.19 per share were paid to all ordinary shareholders on record as of September 12 and December 9. In 2007, four quarterly dividends were paid at $0.38 per share to all ordinary shareholders of record as of March 15, June 11, September 10 and December 10.

In February 2009, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend payable in March 2009. At December 31, 2008, the Company had a retained deficit of $315.5 million and as allowed under Cayman law, the Company will pay dividends in March 2009 from additional paid in capital.

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

As a holding company, the Company s principal source of income is dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries that the Company operates in, including Bermuda, the U.S. and the U.K., and those of the Society of Lloyd s, and certain contractual provisions. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Note 26 to the Consolidated Financial Statements, Statutory Financial Data, for further discussion.

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

Recent Sales of Unregistered Securities

Unregistered issuances of the Company s equity securities were previously disclosed in the Company s Current Report on Form 8-K, filed on July 28, 2008.

Purchases of Equity Securities by the Issuer and Affiliate Purchases

The following table provides information about purchases by the Company during the quarter ended December 31, 2008 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October	4,615	$ 12.03		$ 375.5 million
November	835	9.70		$ 375.5 million
December	18,217	4.10		$ 375.5 million
Total	23,667	$ 5.85		$ 375.5 million

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

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

(2) On September 24, 2007, the Board of Directors of the Company approved a share repurchase program, authorizing the Company to repurchase up to $500.0 million of its Class A ordinary shares. During the year ended December 31, 2008, no share repurchases were made under the share repurchase program. As at December 31, 2008,

the Company could repurchase $375.5 million of its equity securities under the share repurchase program.

Class A Ordinary Share Performance Graph

Set forth below is a line graph comparing the yearly dollar change in the cumulative total shareholder return, with all dividends reinvested, over a five-year period on the Company s Class A ordinary shares from December 31, 2003 through December 31, 2008 as compared to the cumulative total return of the Standard & Poor s 500 Stock Index and the cumulative total return of the Standard & Poor s Property & Casualty Insurance Index.

ITEM 6. SELECTED FINANCIAL DATA

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

	2008	2007	2006	2005	2004
	(U.S. dollars in thousands, except per share amounts)				
Income Statement Data:					
Net premiums earned	$ 6,640,102	$ 7,205,356	$ 7,569,518	$ 9,365,495	$ 8,582,0
Net investment income	1,768,977	2,248,807	1,978,184	1,475,039	1,035,0
Net realized (losses) gains on investments	(962,054)	(603,268)	(116,458)	241,882	246,5
Net realized and unrealized (losses) gains on derivative instruments	(73,368)	(55,451)	101,183	28,858	73,4
Net (loss) income from investment fund affiliates (1)	(277,696)	326,007	269,036	154,844	124,0
Fee income and other	52,158	14,271	31,732	19,297	35,3
Net losses and loss expenses incurred (2)	3,962,898	3,841,003	4,201,194	7,434,336	4,865,1
Claims and policy benefits life operations	769,004	888,658	807,255	2,510,029	1,526,9

Acquisition costs, operating expenses and foreign exchange gains and losses	1,921,940	2,188,889	2,374,358	2,188,357	2,277,3
Interest expense	351,800	621,905	552,275	403,849	292,2
Extinguishment of debt	22,527				
Impairment of goodwill	989,971				
Amortization of intangible assets	2,968	1,680	2,355	10,752	15,8
(Loss) income before minority interests, net income from operating affiliates and income tax expense	(872,989)	1,593,587	1,895,758	(1,261,908)	1,118,9
(Loss) income from operating affiliates (1)(2)	(1,458,246)	(1,059,848)	111,670	67,426	143,3
Preference share dividends	78,645	69,514	40,322	40,322	40,3

	2008	2007	2006	2005	
	(U.S. dollars in thousands, except per share amounts)				
Net (loss) income available to ordinary shareholders	$ (2,632,458)	$ 206,375	$ 1,722,445	$ (1,292,298)	$ 1
Per Share Data:					
Net (loss) income per ordinary share basic (3)	$ (11.02)	$ 1.16	$ 9.63	$ (9.14)	$
Net (loss) income per ordinary share diluted (3)	$ (11.02)	$ 1.15	$ 9.60	$ (9.14)	$
Weighted average ordinary shares outstanding diluted (3)	238,862	179,693	179,450	141,406	
Cash dividends per ordinary share	$ 1.14	$ 1.52	$ 1.52	$ 2.00	$
Balance Sheet Data:					
Total investments available for sale	$ 27,464,510	$ 36,265,803	$ 39,350,983	$ 35,724,439	$ 27
Cash and cash equivalents	4,353,826	3,880,030	2,223,748	3,693,475	2
Investments in affiliates.	1,552,789	2,611,149	2,308,781	2,046,721	1
Unpaid losses and loss expenses recoverable	3,997,722	4,697,471	5,027,772	6,441,522	6
	3,377,016	3,637,452	3,591,238	3,799,041	3

Premiums receivable					
Total assets	45,682,005	57,762,264	59,308,870	58,454,901	49
Unpaid losses and loss expenses	21,650,315	23,207,694	22,895,021	23,597,815	19
Future policy benefit reserves	5,452,865	6,772,042	6,476,057	5,776,318	4
Unearned premiums	4,217,931	4,681,989	5,652,897	5,388,996	5
Notes payable and debt	3,189,734	2,868,731	3,368,376	3,412,698	2
Redeemable preference ordinary shares	500,000				
Shareholders equity	6,115,233	9,948,142	10,131,166	8,471,811	7
Book value per ordinary share	$ 15.46	$ 50.30	$ 53.12	$ 44.31	$
Operating Ratios:					
Loss and loss expense ratio (4)	66.1 %	59.8 %	62.2 %	107.4 %	
Underwriting expense ratio (5)	29.6 %	29.0 %	27.3 %	25.6 %	
Combined ratio (6)	95.7 %	88.8 %	89.5 %	133.0 %	

(1) The Company generally records the income related to alternative fund affiliates on a one month lag and the private investment

fund affiliates on a three month lag in order for the Company to meet the accelerated filing deadlines. The Company generally records the income related to operating affiliates on a three month lag.

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

reinsurance agreements with Syncora were recorded within net loss from operating affiliates.

(3) Net income per ordinary share is based on the basic and diluted weighted average number of Class A ordinary shares and share equivalents outstanding for each period. Net loss per ordinary share is based on the basic weighted average number of ordinary shares outstanding.

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

(5)

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

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

underwriting
loss.

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

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

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

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

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Executive Overview

Background

The Company operates on a global basis and is a leading provider of insurance and reinsurance coverages to industrial, commercial and professional service firms, insurance companies and other enterprises, typically the global equivalent of the Fortune 2000. The Company operates in markets where it believes its underwriting expertise and financial strength represent a relative advantage.

The Company has grown through acquisitions and development of new business opportunities. Acquisitions included Global Capital Re in 1997, Mid Ocean Limited in 1998, ECS, Inc. and NAC Re Corp. in 1999, Winterthur International in 2001 and Le Mans Re in 2002. All acquisitions were entered into in order to further support the Company s strategic plan to develop a global platform in insurance and reinsurance. The Company competes as an integrated global business and at December 31, 2008 employed approximately 4,000 employees in 28 countries. Subsequent to December 31, 2008, the Company announced a restructuring initiative which will result in the Company s workforce decreasing by approximately 10% during 2009.

Underwriting Environment

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

Insurance

Throughout 2008, the Company s Insurance segment continued to experience soft property and casualty market conditions as premium rates across most lines of business as compared to the prior year, decreased by approximately 6% in the aggregate and competitive pressures continued. Throughout 2008, property renewals reflected decreases in premium rates of approximately 12% on average, while certain casualty lines experienced premium rate reductions averaging approximately 9%. In addition, premium rates within certain specialty lines of business decreased by up to 5%. Offsetting these premium rate decreases was strong pricing in the U.S. professional Directors and Officers (Directors and Officers) book of business, specifically with regards to financial institutions, and more recently on the offshore energy book as a result of market losses from Hurricanes Gustav and Ike.

In addition, during 2008, new business writings were impacted by market conditions as competitors continued to focus on retaining business in all lines and markets. However, during this period, the Company wrote approximately $900 million in new business (excluding program business and long-term agreements). This was largely a result of successes in the Company s organic growth strategies which include E&S, private D&O as well as construction and upper middle market. Renewal ratios for core property, casualty and professional lines were approximately 83%. However, following the rating agency actions taken in December 2008 (see Ratings , above), the Company experienced a slight decline in renewal activity and new business opportunities in certain lines of business. For further information on recent rate and renewal activity, see 2009 Underwriting Outlook below for further information.

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

	2008			2007 (3)		
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**N Pren Ea**
Casualty professional lines	1,472,874	1,351,237	1,369,668	$ 1,516,412	$ 1,376,819	$ 1
Casualty other lines	1,273,016	793,512	822,252	1,342,817	848,919	
Property catastrophe	(65)	(2,177)	270	15,312	(7,460)	
Other property	886,483	505,564	471,013	871,009	599,668	
Marine, energy, aviation, and satellite	747,311	604,786	621,774	809,073	623,085	
Other specialty lines (1)	850,404	712,307	660,322	786,074	666,208	
Other (2)	22,736	(22,908)	(11,055)	36,698	27,439	
Structured indemnity	56,155	42,505	62,801	56,871	52,177	
Total	5,308,914	3,984,826	3,997,045	$ 5,434,266	$ 4,186,855	$ 4

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

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

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

Reinsurance

In the Reinsurance segment, the year ended December 31, 2008 reflected a decline in premium rates across most major lines of business, as market conditions continued to soften and the reinsurance industry continued to experience pricing erosion, increased competitive pressures and increased retentions by cedants. Renewals and new business in 2008 continued to be assessed against internal hurdle rates with a continued focus on underwriting discipline. U.S. and non-U.S. catastrophe exposed property lines experienced rate declines of approximately 10% while other property lines of business saw rates decrease by 10% to 15%. Ocean marine pricing rates remained flat to down 5%, while rates within the aviation market decreased by up to 10%. Casualty pricing trends in the reinsurance market experienced deterioration in rates of up to 15%, however, rate changes on business actually bound in this line of business decreased between 10 to 15%. However, with increased hurricane and other loss activity during the latter half of 2008, taken together with the distressed state of the financial markets, rate declines across all lines of business began to slow in the latter half of 2008.

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

	2008			2007		
(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Ne Prem Ear**
Casualty professional lines	$ 213,519	$ 213,498	$ 247,979	$ 256,280	$ 256,327	$ 2
Casualty other lines	356,723	347,849	425,541	543,251	527,860	6
Property catastrophe.	401,740	290,443	305,690	475,540	286,866	2
Other property	947,899	602,423	678,504	970,196	677,764	7
Marine, energy, aviation, and satellite	119,593	104,346	126,761	150,548	128,942	1
Other (1)	220,332	194,237	205,433	239,418	204,845	2
Structured	671	671	3,298	28,261	28,261	

indemnity												
Total	$	2,260,477	$	1,753,467	$	1,993,206	$	2,663,494	$	2,110,865	$	2,3

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

The following sets forth potential trends relevant to the Company s property and casualty operations in 2009:

2009 Underwriting Outlook

Given the changing economic environment that has been experienced throughout 2008 and early 2009 due to the global economic and financial crises and following the significant impacts to the Company during 2008, including the downgrade of the financial strength ratings of the Company s core insurance and reinsurance subsidiaries by leading rating agencies, the Company plans to focus on those lines of business within its insurance and reinsurance operations that provide the best return on capital over the pricing cycle. As such, the Company will be highly selective on new business, emphasize short-tail lines, where applicable, in the Company s reinsurance operations, exit other businesses (e.g., Casualty facultative business), non-renew certain insurance programs, as well as continue to reduce long-term agreements (within the insurance operations) in order to capture the benefit of improving pricing. While certain of these decisions as well as any lost business as a result of rating agency downgrades will result in a reduction to both gross and net premiums written in 2009, the Company expects such negative impacts to be partially offset by the positive impact of hardening rates across most lines of business as described below.

Throughout 2007 and the majority of 2008, the property and casualty insurance and reinsurance markets experienced soft market conditions across most, if not all lines of business, as evidenced by decreases in market pricing and a weakening of policy terms and conditions. However, following catastrophe activity throughout 2008, most notably, losses resulting from Hurricanes Ike and Gustav, and more importantly, following severe economic conditions and the impacts of the financial crisis, which reduced the available capital of many property and casualty (re)insurers, market capacity decreased and in conjunction, market pricing across most insurance and reinsurance lines of business began to improve and is expected to continue improving throughout 2009. The following is a summary of the January 2009 rate indications and recent renewal activity for each of the Insurance and Reinsurance segments of the Company:

Insurance

With regards to market conditions within the core lines of business within the Insurance segment, fourth quarter 2008 renewals reflected modest improvement in market conditions as premium rates improved across all line of business and certain lines experienced rate increases. Overall, December 2008 renewals reflected an aggregate price increase of 1% for the entire book. More specifically, December premium rates increased approximately 5% in professional lines, 10% in offshore energy and well over 10% in the Company s specie book. Rates in both property and casualty were down in the low single digits. Initial indications based on January 2009 renewals reflect continued rate improvement with positive rate movement in property, professional and some specialty lines. Rates within the Company s casualty lines were down slightly by approximately 3%, which represents a significant improvement as compared to rate declines experienced in 2008.

While the Insurance segment s gross and net premiums written will be impacted by its decision to focus on those lines of business that provide the best return on capital as described above, as well as from a certain level of lost renewals or business opportunities as a result of rating agency actions taken throughout 2008, indications from recent underwriting activity highlight that retention rates remain strong and broadly in line with management s expectations.

Reinsurance

Across the Reinsurance segment, initial indications, based on January 1, 2009 renewals, point to a moderate rise in premium rates across most major lines of business. Market conditions continue to harden as a result of the reduction in available reinsurer capital, due in part to the credit and liquidity crisis, causing a firming in market pricing across most lines of business. U.S. and non-U.S. catastrophe exposed property lines experienced rate increases of approximately 15% and 5% respectively, while other property lines in the U.S. were generally flat. While U.S. casualty rates, excluding D&O, were down slightly, casualty motor rates in Europe saw increases of up to 10% with rates in other casualty lines remaining flat. In addition, aviation and marine lines of business experienced rate increases of between

5 to 10%.

Initial indications of renewal activity have been positive, despite the expected impact of lost renewals and new business opportunities as a result of the rating agency actions taken in December 2008, most notably, the downgrade by S&P, especially in Europe. While some insurers chose not to renew their business with the Company, overall, the negative impact on gross and net premiums written based on such renewal activity has been partially offset by the increase in rates as noted above.

Investment Environment

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

During the year ended December 31, 2008, financial market conditions continued to be extremely challenging as the global credit crisis that began in July 2007, continued to adversely impact global markets. This unprecedented market volatility directly and materially affected the Company s results of operations and investment portfolio during the year ended December 31, 2008, resulting in decreased net investment income and increases in both realized and unrealized losses in the Company s investment portfolio. The fixed income markets experienced a period of extreme volatility during 2008, negatively impacting market liquidity conditions. As a result, the market for fixed-income instruments experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Domestic and international equity markets also experienced heightened volatility and turmoil during this period.

During 2008, the Company reported significant decreases in both its structured credit and corporate portfolios as a result of the negative conditions described above. Within the structured credit portfolio, the market conditions particularly impacted the Company s holdings in sub-prime non-agency securities, second liens, ABS CDOs with sub-prime collateral and Alt-A mortgages (Topical Assets), core collateralized debt obligations (CDOs) and commercial mortgage-backed securities (CMBS). Within the corporate portfolio, the Company s financial sector holdings were particularly affected as credit spreads, which widened across the entire rating spectrum impacted all spread assets classes, particularly financials following the bankruptcy of Lehman Brothers Holdings Inc. (Lehman) in September 2008 and the subsequent failure or near failure of other financial institutions. The impact of the credit spread widening was partially offset by the increase in the fixed income portfolio which resulted from declining government interest rates.

Claims Environment

The Company s profitability in any given period is based upon its premium and investment revenues as noted above, less net losses incurred and expenses. Net losses incurred are based upon claims paid and changes to unpaid loss reserves. Unpaid loss reserves are estimated by the Company and include both reported loss reserves and reserves for losses incurred but not reported, or IBNR. The Company s lower underwriting results for 2008 as compared to 2007 were largely a reflection of the increase in catastrophe and property risk losses experienced in 2008. However, offsetting the current year incurred losses was $610.7 million of net favorable prior year reserve development in various lines of business within the Company s Insurance and Reinsurance segments. In contrast, the Company s positive underwriting results for 2007 and 2006 were partly a result of the lack of significant catastrophe events occurring throughout these years as well as net favorable development of prior year reserves. However, consistent with 2006 and 2007, net favorable development was partially offset in 2008 by the continuing increase in current period loss ratios during this period. The increase in 2008 reflects the impact of the softening rate environment as well as higher levels of catastrophe and attritional losses as noted above. In addition, in 2008, claims activity within the D&O and Errors and Omissions (E&O) insurance markets overall, rose as a result of an increase in class action lawsuits filed against public companies due to market losses and related stock price depreciation associated with the sub-prime mortgage and credit crisis in the U.S. Management actively monitors its potential exposure to such events and gives due consideration to emerging claim trends in determining its loss reserve requirements at each quarter end.

For further analysis of this exposure, see Results of Operations below.

Financial Measures

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

(U.S. dollars in thousands, except ratios and per share amounts)	**2008**	**2007**	**2006**
Underwriting profit property and casualty operations	$ 307,205	$ 737,449	$ 733,633
Combined ratio property and casualty operations	95.7 %	88.8 %	89.5 %
Net investment income property and casualty operations (1)	$ 1,174,856	$ 1,289,554	$ 1,090,785
Book value per ordinary share	$ 15.46	$ 50.30	$ 53.12
Fully diluted book value per ordinary share (2)	$ 15.46	$ 50.29	$ 53.01
Return on average ordinary shareholders equity	NM *	2.2 %	19.6 %

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

(2) Fully diluted book value per ordinary share represents book value per ordinary share combined

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

* NM Not Meaningful

Underwriting profit (loss) property and casualty operations

One way that the Company evaluates the performance of its insurance and reinsurance operations is the underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned and fee income, less net losses incurred and expenses related to underwriting activities, plus unrealized foreign exchange gains and losses on underwriting balances. The Company s underwriting profit in the year ended December 31, 2008 was primarily reflective of the combined ratio discussed below. The Company s strong property and casualty underwriting profit for 2007 and 2006 were partly a result of the lack of significant catastrophe events occuring throughout these years and net favorable prior year loss development. Any changes to loss reserves affect the calculation of underwriting profit or loss but most often do not directly affect the Company s cash flow in the same period.

Combined ratio property and casualty operations

The combined ratio for property and casualty operations is used by the Company and many other insurance and reinsurance companies as another measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net premiums earned for the Company s general insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and over 100% indicates an underwriting loss.

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

The Company s combined ratio for the year ended December 31, 2007 was lower than the previous year, primarily as a result of a lower loss and loss expenses ratio partially offset by a higher underwriting expense ratio. The lower loss and loss expense ratio has resulted mainly from higher net favorable prior year development in the year ended December 31, 2007 as compared to the same period in 2006, while the increased underwriting expense ratio was driven largely by increased compensation costs and continued pricing pressures that have resulted in less premium earned.

Net investment income property and casualty operations

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

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

The increase in net investment income in 2007 was primarily due to several years of positive operating cash flows which resulted in a higher overall average invested asset base. In addition, during 2007, portfolio yields increased in the Company s investment portfolio, due primarily to the full 2007 financial year impact of the higher interest rates experienced in the U.S., U.K. and Euro-zone, during the latter part of 2006 and the beginning part of 2007.

Book value per ordinary share

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

Book value per ordinary share decreased by $34.84 in the year ended December 31, 2008 as compared to a decrease of $2.82 during 2007 as noted below. The decrease in 2008 was primarily as a result of the Company s issuance of Class A ordinary shares issued at a discount to book value (as described below), the Company s net loss of $2.6 billion during the year ended December 31, 2008 and the increase in net unrealized losses on investments of approximately $2.9 billion, net of tax, during the same period. In addition, book value per ordinary share decreased as a result of unfavorable foreign currency translation adjustments of $472.3 million during the year ended December 31, 2008. In August 2008, the Company issued 143.8 million Class A ordinary shares at a price of $16.00 per share, which was lower than the Company s book value per ordinary share at the time and thus dilutive. The Company s net loss of $2.6 billion was mainly due to the impact of the closing of the Master Agreement in August 2008 as described above, the goodwill impairment charge recorded in 2008 of $990.0 million, catastrophe and attritional losses, as well as from net realized losses on investments and losses from investment fund affiliates during the year ended December 31, 2008. The increase in net unrealized losses on investments of $2.9 billion, net of tax, during the year ended December 31, of 2008 was mainly as a result of widening credit spreads on corporate and structured credit assets, offset by declines in interest rates, while unfavorable foreign currency translation adjustments during the same period resulted from the increase in value of the U.S. dollar against most major currencies, predominately the Euro and U.K. Sterling.

Book value per ordinary share decreased by $2.82 during the year ended December 31, 2007 to $50.30 from $53.12. The decrease in book value per share in 2007 was primarily as a result of an increase in net unrealized losses on investments of $743.0 million, net of tax, partially offset by net income of $206.4 million for the year ended December 31, 2007, which increased book value, together with an increase in currency translation adjustments due to the impact of the decline in the value of the U.S. dollar on the net assets of European-based subsidiaries. In addition, certain capital and financing activities impacted book value per ordinary share, including the Company s share repurchase activity throughout 2007 which decreased book value per ordinary share, as the price paid for such shares was at a premium to book value; however, this was partially offset by the issuance of Class A ordinary shares upon maturity of the purchase contracts associated with the 6.5% Equity Security Units (the 6.5% Units), as the ordinary shares were issued at a premium to book value.

As noted above, fully diluted book value per ordinary share represents book value per ordinary share combined with the impact from dilution of share based compensation including in-the-money stock options at any period end. Fully diluted book value per ordinary share decreased by $34.83 during the year ended December 31, 2008 as a result of the factors noted above and is consistent with the decrease in basic book value per ordinary share as there were no in-the-money stock options at December 31, 2008 as a result of the reduction in market price of the Company s ordinary shares in 2008.

Return on average ordinary shareholders equity

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

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

In 2007, ROE was 2.2%, 17.4 percentage points lower than the prior year, primarily as a result of losses recorded in the second half of 2007 in relation to adverse credit market conditions, including but not limited to, losses associated with the Company s investment in and reinsurance agreements with Syncora and realized losses, including other than temporary impairment charges (OTTI), in the Company s investment portfolio. For further details of these losses, see Results of Operations below. Partially offsetting these decreases were strong underwriting results in 2007 within the Company s core property and casualty operations and lower levels of shareholders equity resulting from capital activity and increases in unrealized losses on investments.

Results of Operations

The following table presents an analysis of the Company s net income (loss) available to ordinary shareholders and other financial measures (described below) for the years ended December 31, 2008, 2007 and 2006:

(U.S. dollars in thousands, except share and per share amounts)	**2008**	**2007**	**2006**
Net (loss) income available to ordinary shareholders	$ (2,632,458)	$ 206,375	$ 1,722,445
(Loss) earnings per ordinary share basic	$ (11.02)	$ 1.16	$ 9.63

(Loss) earnings per ordinary share diluted	$	(11.02)	$	1.15	$	9.60
Weighted average number of ordinary shares and ordinary share equivalents basic		238,862		178,500		178,793
Weighted average number of ordinary shares and ordinary share equivalents diluted		238,862		179,693		179,450

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

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

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

3) continuing competitive underwriting environment;

4) net prior year favorable loss development;

5) impact of increased property risk and catastrophe activity 2008 and limited property risk catastrophe activity in 2007 and 2006; and

6) goodwill impairment charge recorded in 2008.

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

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

After the closing of the Master Agreement on August 5, 2008, approximately $64.6 billion of the Company s total net exposure (which was $65.7 billion as at June 30, 2008) under reinsurance agreements and guarantees with Syncora subsidiaries was eliminated. Pursuant to the terms of the Master Agreement, Syncora is required to use commercially reasonable efforts to commute the agreements that are the subject of the Company s guarantee of Syncora Guarantee s obligations under certain financial guarantees issued by Syncora Guarantee to the European Investment Bank (the EIB Policies), subject to certain limitations. As at December 31, 2008, the Company s exposures relating to the EIB Policies (which relate to project finance transactions) was approximately $955.4 million reduced from $1.1 billion at June 30, 2008 mainly due to the strengthening of the U.S. dollar against the currencies of the underlying obligations. As of December 31, 2008, there had been no reported events of default on the underlying obligations, accordingly, no reserves have been recorded.

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

(U.S. dollars in millions)		
Carried liabilities in relation to reinsurance and guarantee agreements commuted under the Master Agreement	$	490.7

Other accruals		(5.2)
Cash payment made to Syncora in August 2008		(1,775.0)
Value of XL common shares transferred under the Master Agreement		(128.0)
Net loss associated with Master Agreement recorded in the year ended December 31, 2008	$	(1,417.5)

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

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

During the year ended December 31, 2008, financial market conditions continued to be extremely challenging as the global credit crisis that began in July 2007, continued to adversely impact global markets. This unprecedented market volatility directly and materially affected the Company s results of operations and investment portfolio during the year ended December 31, 2008. The credit markets experienced a period of extreme deterioration during 2008, negatively impacting market liquidity conditions. As a result, the market for fixed-income instruments experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Domestic and international equity markets also experienced heightened volatility and turmoil during this period.

During 2008, the Company reported significant decreases in both its structured credit and corporate portfolios as a result of the negative conditions described above. Within the structured credit portfolio, the market conditions particularly impacted the Company s holdings in Topical Assets, CDOs and CMBS. Within the corporate portfolio, the Company s financial sector holdings were particularly affected as credit spreads, which widened across the entire rating spectrum impacted all spread assets classes, particularly financial institutions following the bankruptcy of Lehman in September 2008 and the subsequent failure or near failure of other financial institutions including Tier One and Upper Tier Two securities (representing committed term debt and hybrid instruments senior to the common and preferred equities of the financial institutions). The impact of the credit spread widening was partially offset by the increase in the fixed income portfolio which resulted from declining government interest rates.

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

	Interest Rate Movement for the year ended December 31, 2008 (1) (- represents decreases in interest rates)	**Credit Spread Movement for the year ended December 31, 2008 (2) (+ represents widening of credit spreads)**
United States	-189 basis points (5 year treasury)	+ 439 basis points (US Corporate A rated)
		+ 72 basis points (US Agency RMBS, AAA rated)
		+ 753 basis points (US CMBS, AAA rated)
United Kingdom	-149 basis points (10 year Gilt)	+ 217 basis points (UK Corporate, AA rated)
Euro-zone	-180 basis points (5 year Bund)	+ 317 basis points (Europe Corporate, A rated)

(1) Source: Bloomberg Finance L.P.

(2) Source: Merrill Lynch Global Indices.

The net impact of the market conditions over the course of 2008 on the Company s investment portfolio for the year ended December 31, 2008 resulted in net realized losses of $962.1 million and an increase in net unrealized losses on available-for-sale investments of $2.9 billion. This represents approximately a 12.2% deterioration on average assets for the year ended December 31, 2008. See Item 1A, Risk Factors, Deterioration in the public debt and equity markets could lead to additional investment losses and We are exposed to significant capital markets risk related to changes in interest rates, credit spreads, equity prices and foreign exchange rates which may adversely affect our results of operations, financial condition or cash flows, above. Since the time of the Company s August 2008 public offering of ordinary shares and equity security units (See Results of Operations Other Key Focuses of Management Capital Management, below), the volatility and disruption in the global capital markets reached unprecedented levels and substantially increased during both the third and fourth quarters of 2008.

During the fourth quarter of 2008, the Company recorded a charge on its investment portfolio for OTTI of $400.0 million in relation to impaired assets that it could no longer assert its intent to hold until recovery. Management believes that these securities were at-risk for further mark-to-market declines, and potentially real economic losses, to the extent that economic conditions were to deteriorate further than present estimates and the Company s allocation to these asset classes is overweight relative to traditional P&C portfolio. By taking the charge as noted above, the Company expects to be able to accelerate its investment portfolio risk reduction exercise during 2009. As a result of the charge noted above, management is likely to pursue targeted sales of these assets over the course of 2009, and expects to realize the associated losses on these securities. The assets are concentrated in certain holdings within the Company s BBB and lower corporate, CMBS, equity and consumer ABS portfolios.

Corporate credit portfolio

The following table details the Company s corporate credit exposures by certain asset classes as well as ratings levels within the Company s fixed maturity portfolio and the current net unrealized (loss) position as at December 31, 2008:

(U.S. dollars in millions)		**AAA**		**AA**		**A**		**BBB**		**BB & Below**	
Financials											
Fair value	$	712.4	$	1,280.6	$	2,153.3	$	343.4	$	64.7	$
Net unrealized (loss)	$	(14.6)	$	(145.4)	$	(659.5)	$	(158.2)	$	(44.0)	$
Non-Financials											
Fair value	$	521.8	$	711.4	$	2,213.2	$	1,511.6	$	552.9	$
Net unrealized (loss)	$	(14.7)	$	(22.6)	$	(307.2)	$	(306.9)	$	(216.6)	$
Total											
Fair value	$	1,234.2	$	1,992.0	$	4,366.5	$	1,855.0	$	617.6	$
Net unrealized (loss)	$	(29.3)	$	(168.0)	$	(966.7)	$	(465.1)	$	(260.6)	$

At December 31, 2008, approximately $1.7 billion of the Company s $4.6 billion in corporate financial sector securities was held in the portfolios supporting the Company s Life Reinsurance Operations. Management continues the strategic analysis of the Company s life reinsurance business. The assets associated with that business are more heavily weighted towards longer term securities from financial institutions, including a significant portion of the Company s Tier 1 and Upper Tier 2 securities, representing committed term debt and hybrid instruments senior to the common and preferred equity of the financial institutions. Financials held in Life portfolios accounted for $663.1 million of the Company s net unrealized loss as at December 31, 2008. As at December 31, 2008 approximately 34.0% of the overall sensitivity to interest rate risk and 37.8% to credit risk was related to the life reinsurance portfolio, despite these portfolios accounting for only 17.6% of the fixed income portfolio.

Structured credit portfolio

The following table details the Company s structured credit exposures by certain asset classes as well as ratings levels within the Company s fixed maturity portfolio and the current net unrealized gain (loss) position as at December 31, 2008:

(U.S. dollars in millions)	**AAA**	**AA**	**A**	**BBB**	**BB & Below**	**Total**
CMBS						
Fair value	$ 2,101.5	$ 15.2	$ 15.4	$ 11.8	$ 10.6	$ 2,154.5
Net unrealized (loss)	$ (331.8)	$ (5.1)	$ (4.9)	$ (7.7)	$ (12.4)	$ (361.9
Prime RMBS						
Fair value	$ 2,862.4	$ 132.1	$ 57.1	$ 14.6	$ 36.3	$ 3,102.5
Net unrealized (loss)	$ (155.7)	$ (67.0)	$ (45.5)	$ (5.0)	$ (13.0)	$ (286.2
Topical Assets						
Fair value	$ 558.3	$ 183.7	$ 98.9	$ 48.0	$ 74.6	$ 963.5
Net unrealized (loss)	$ (312.5)	$ (157.5)	$ (63.4)	$ (24.7)	$ (36.5)	$ (594.6
Core CDOs (1)						
Fair value	$ 166.1	$ 324.4	$ 51.7	$ 110.3	$ 13.7	$ 666.2
Net unrealized (loss)	$ (61.7)	$ (173.9)	$ (46.6)	$ (163.7)	$ (24.1)	$ (470.0
Other Asset & Mortgage Backed Securities						
Fair value	$ 1,253.3	$ 108.1	$ 267.6	$ 61.7	$ 28.2	$ 1,718.9
Net unrealized (loss)	$ (57.3)	$ (18.3)	$ (74.1)	$ (28.9)	$ (2.3)	$ (180.9
Total						
Fair value	$ 6,941.6	$ 763.5	$ 490.7	$ 246.4	$ 163.4	$ 8,605.4
Net unrealized	$ (919.0)	$ (421.8)	$ (234.5)	$ (230.0)	$ (88.3)	$ (1,893.6

(loss)

(1) The Company defines Core CDOs as investments in non-mortgage collateralized debt obligations, primarily consisting of collateralized loan obligations.

The following table details the current exposures to Topical Assets within the Company s fixed income portfolio as well as the current net unrealized (loss) gain position as at December 31, 2008 and December 31, 2007:

	As at December 31, 2008			As at December 31, 2007		
(U.S. dollars in thousands)	**Holding at Fair Value**	**Percent of Fixed Income Portfolio**	**Net Unrealized (Loss) Gain**	**Holding at Fair Value**	**Percent of Fixed Income Portfolio**	**Net Unrealized (Loss) Gain**
Topical Assets:						
Sub-prime first lien mortgages	$ 487,659	1.5 %	$ (311,435)	$ 995,947	2.5 %	$ (145,785)
Alt-A mortgages	406,098	1.3 %	(270,486)	924,783	2.3 %	(40,145)
Second lien mortgages (including sub-prime second lien mortgages)	58,903	0.2 %	(5,313)	97,647	0.3 %	788
ABS CDOs with sub-prime collateral	10,595	0.0 %	(7,308)	39,317	0.1 %	101
Total exposure to Topical	$ 963,255	3.0 %	$ (594,542)	$ 2,057,694	5.2 %	$ (185,041)

Assets

Of the total Topical Assets with fair value exposure as at December 31, 2008 and December 31, 2007 of $1.0 billion and $2.0 billion, respectively, approximately $40.5 million and $76.8 million, respectively, of the related securities had ratings dependent on guarantees issued by third party guarantors (i.e., monoline insurers). Decreases in the ratings of such third party guarantors would typically decrease the fair value of guaranteed securities; however, at December 31, 2008, in the event of non-performance at such date on the part of these third party guarantors, the Company estimated that the average credit quality of this portfolio would be A and that approximately 96.1% would have remained investment grade at such date. In addition, of the total fixed income portfolio as at December 31, 2008 and December 31, 2007, of $31.9 billion and $39.6 billion, respectively, less than 2% were guaranteed by such third parties with no individual third party representing more than 1%.

At December 31, 2008, the Company s sub-prime and Alt-A exposures remained primarily highly rated, had adequate underlying loan characteristics and the Company believed at such date that they were supported by adequate subordination levels based on current expectations of house price declines, loss severities and default levels. The Company had approximately $523.1 million of Topical Assets downgraded during the year ended December 31, 2008. However, 92.2% of the Company s holdings remain rated investment grade at December 31, 2008.

Liquidations necessary to fund the repayment of the GIC liabilities following the downgrade of Syncora Guarantee and the maturity of certain funding agreements were funded through sales of assets in the Other Financial Lines segment investment portfolios as well as the general investment portfolio. Management s approach was to avoid the sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold approximately $1.4 billion of Topical Assets and core CDOs and these have been transferred to the general portfolio in exchange for those assets that were liquidated.

Realized losses and other than temporary impairments

Net realized losses on investments in the twelve months ended December 31, 2008 included net realized losses of approximately $1,023.6 million related to the write-down of certain of the Company s fixed income, equity and other investments, including Lehman, where the Company determined that there was an other than temporary decline in the value of those investments, including a charge of $400.0 million related to assets for which the Company could no longer assert its intent to hold to recovery. See below for further information. Included in net realized losses noted above are net realized gains of $98.8 million as related to the foreign exchange component of inter-company sales of assets.

During the year ended December 31, 2008, net realized losses of $400.0 million related to the write-down of certain of the Company s fixed income and equity investments, where, although management s analysis of the securities indicated that these assets were expected to pay out all expected cash flows, management can no longer assert that it intends to hold these securities until such time as they recover, as management intends to pursue sales of these securities in connection with its efforts to reduce the risk within the Company s the investment portfolio.

Included in the impairment charge for the year ended December 31, 2008, was $121.4 million of related exposures to financial institutions, primarily related to Lehman. The remaining impairment during 2008 was spread across the portfolio including structured credit, equity and other fixed income investments, with $228.5 million related to securities with sub-prime and Alt- A collateral which are included in the table below. Consistent with prior quarters, management continues to evaluate the impairment of the portfolio and satisfy itself that the remaining gross unrealized losses are temporary in nature.

The following table provides the realized and unrealized impact related to the Topical Assets during the year ended December 31, 2008:

	Year Ended December 31, 2008	
(U.S. dollars in thousands)	**Realized (Loss) and (Impairments)**	**Change in Net Unrealized (Loss)**
Topical Assets:		
Sub-prime first lien mortgages	$ (124,518)	$ (165,650)
Alt-A mortgages	(118,318)	(230,341)
Second lien mortgages (including sub-prime second lien mortgages)	(15,664)	(6,101)

ABS CDOs with sub-prime collateral		(17,209)		(7,409)
Total	$	(275,709)	$	(409,501)

All portfolio holdings, including those with sub-prime exposure, are reviewed as part of the ongoing other than temporary impairment monitoring process. The Company continues to actively monitor its exposures, and to the extent market disruptions continue, including but not limited to disruptions in the residential mortgage market and the related impacts on the assumptions embedded in the Company s impairment assessments and estimates of future cash flows, the Company s financial position could be negatively impacted. See Item 1A, Risk Factors Deterioration in the public debt and equity markets could lead to additional investment losses, above.

Alternative investment portfolio

Net income from investment fund affiliates was negative in the year ended December 31, 2008. Broad-based market declines, combined with extreme volatility, a sharp pull-back in the availability of credit and short sale restrictions implemented by securities market regulators, proved highly challenging for the strategies employed by many of the Company s alternative investment managers. The Company s alternative investments are managed to maximize total-return on a risk-adjusted basis, and the results during 2008 as compared to 2007 were reflective of different market conditions and opportunities available over these periods.

3. Continuing competitive underwriting environment

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

In addition, in the latter part of 2008, unprecedented economic conditions continued to impact the Company. These conditions, combined with the recent volatility in the Company s share price, rating agency actions with respect to the Company and issues faced by some of the Company s competitors, resulted in the creation of challenges as well as certain opportunities for the Company s P&C operations.

4. Net prior year favorable loss development

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

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

(U.S. dollars in millions)		**2008**		**2007**		**2006**
Insurance segment	$	(305.5)	$	(158.1)	$	(13.2)
Reinsurance segment		(305.2)		(267.3)		(97.4)
Total	$	(610.7)	$	(425.4)	$	(110.6)

During 2008, net favorable prior year development totaled $610.7 million in the Company s property and casualty operations and included net favorable development in the Insurance and Reinsurance segments of $305.5 million and $305.2 million, respectively. Within the Reinsurance segment, net favorable prior year reserve development included casualty and other lines reserve releases in both European and U.S. casualty and professional portfolios as well as reserve releases associated with the RITC relating to the 2005 year of account on certain Lloyd s sourced business. In the same period, property and other short-tail lines net favorable development was attributable to most business units globally. The Insurance segment net favorable prior year reserve development was due to reserve releases in global property lines of business as a result of favorable claim development as well as reserve releases in certain casualty lines primarily in accident years 2003 to 2006 years due to lower than expected reported loss activity. In addition, net reserve releases of approximately $80.9 million resulted from an agreement with Axa/Winterthur in the fourth quarter of 2008 in regards to certain reinsurance recoverable balances relating to casualty lines and to a lesser extent, certain property lines of business. Offsetting this favorable development was modest reserve strengthening within environmental lines as well as strengthening associated with certain structured indemnity contracts. Within the professional lines, reserve releases in the 2003 to 2006 accident years were largely offset by strengthening of reserves in the 2007 year.

During 2007, the Company had net favorable prior year reserve development in property and casualty operations of $425.4 million compared to $110.6 million for the same period in 2006. Reinsurance net favorable development accounted for $267.3 million of the release in 2007, while net favorable development within the Insurance segment totaled $158.1 million for the same period. The corresponding prior year development on a gross basis was $259.7 million for the Reinsurance segment and $177.6 million for the Insurance segment. Within the Reinsurance segment, reserve releases of $188.7 million in property and other short-tail lines of business and $87.4 million in casualty and other lines, were partially offset by adverse prior year development of $8.8 million within the structured indemnity line of business. The Insurance segment s net prior year reserve releases consisted of $95.0 million in property and $162.1 million in casualty lines of business, partially offset by net adverse development of $23.0 million, $7.0 million and $69.0 million in certain professional, marine and other lines of business, respectively.

During 2006, the Company had net favorable prior year reserve development in property and casualty operations of $110.6 million. Within the Insurance segment, net overall favorable prior year reserve development for the year ended December 31, 2006, was $13.2 million, while net favorable development within the Reinsurance segment during the same period was $97.4 million.

See Item 8, Note 12 to the Consolidated Financial Statements and see further discussion under Critical Accounting Policies and Estimates .

5. Impact of increased property risk and catastrophe activity in 2008 and limited property risk and catastrophe activity in 2007 and 2006

As compared to 2006 and 2007, 2008 saw increases in property risk losses as well as catastrophe activity and resulting incurred losses, primarily related to U.S. windstorm activity. On September 1, 2008, Hurricane Gustav hit the Louisiana coast of the U.S. as a Category 2 hurricane, causing considerable damage to insured property and loss of life. On September 13, 2008, Hurricane Ike made landfall near Galveston, Texas as a strong Category 2 hurricane, causing significantly more damage and loss of life than Hurricane Gustav. Based on market estimates, Hurricane Ike is estimated to have caused the third largest ever insured loss in the U.S. from a wind storm. The Company has estimated losses incurred, net of reinsurance recoveries and reinstatement premiums, of $22.5 million and $210.0 million related to Hurricanes Gustav and Ike, respectively. Actual losses may vary from this estimate based on a number of factors, including receipt of additional information from insureds and brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. In addition to natural peril catastrophes, there was also an increase in large property risk losses globally during 2008 that contributed to higher loss ratios in both the Insurance and Reinsurance segments.

Overall, 2007 and 2006 experienced a lower number of natural catastrophes as compared to 2008, although 2007 did result in an increase in overall natural catastrophe activity and insured losses as compared to 2006. In 2007, six hurricanes formed in the Atlantic region including two Category 5 hurricanes, while other natural catastrophes in 2007 included European windstorms Kyrill and Per/Hanno, California wildfires, floods in the U.K. and Mexico, the Peruvian earthquake and five hurricanes in the Eastern Pacific region. In 2006, there were only five hurricanes in the Atlantic region and more importantly there was no significant insured damage for those hurricanes that did make landfall.

6. Goodwill impairment charge recorded in 2008

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

Other Key Focuses of Management

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

Simplify the Company s Business Model and Enhance Risk Management

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

Focus on P&C Businesses: In order to support the Company s focus on its dual platform of Insurance and Reinsurance P&C businesses, the Company ceased certain operations that included the closure of the XLFS business unit and reassignment of responsibility for structured indemnity business to either the Insurance segment or Reinsurance segment depending on the underlying nature of the transactions. As noted above, going forward, the Company plans to focus on those lines of business within its insurance and reinsurance operations that provide the best return on capital. As such, the Company will be highly selective on new business, emphasize short-tail lines, where applicable, in the Company s reinsurance operations, exit other businesses (e.g., Casualty facultative business), non-renew certain insurance programs, as well as continue to reduce long-term agreements (within the insurance operations) in order to capture the benefit of hardening markets. In addition, the Company announced its intention to review strategic opportunities relating to its

Life reinsurance business which resulted in the Company selling the renewal rights to its life, accident and health business, a relatively small block of business, in late 2008. The Company continues to explore various strategic options for its annuity book, the mortality and critical illness book and as well for its U.S. life reinsurance business.

Enterprise Risk Management: The Company is focused on enhancing its risk management capabilities throughout all facets of its operations. This initiative is led by the Company s newly hired Chief Enterprise Risk Officer (CERO) as noted below.

The CERO is supported by, among others, the Company s Enterprise Risk Management Committee (the ERM Committee) comprised of the most senior risk takers and managers of the Company. The ERM Committee will continue to assist with the efficient identification, assessment, monitoring, and reporting of key risks across the Company. On September 15, 2008, Mr. Jacob D. Rosengarten joined the Company as Executive Vice President and CERO. Mr. Rosengarten reports directly to the Company s Chief Executive Officer, Michael S. McGavick, and chairs the Company s ERM Committee. In addition, the

Board of Directors has created a special committee of the Board to oversee endeavours in this area.

Simplify Investment Portfolio Over Time: In order to reposition the Company s investment portfolio to one that supports a P&C focused operation, the Company began repositioning the portfolio in 2008 so that a) book value volatility particularly related to credit spreads arising from the portfolio is reduced, b) a reduction in lower rated corporate securities and financial issuers is achieved, c) exposure to CMBS securities is reduced and d) a reduction in asset classes such as subprime, Alt-A and

Core CDO s previously supporting Other Financial Lines activities is achieved. Realignment will be achieved primarily through cash generated from bond maturities and coupon reinvestment, cash flow from business operations as well as certain opportunistic sales.

Consistent with this strategy, management continued the process of reducing risk in the investment portfolio during the latter part of 2008. Fannie Mae and Freddie Mac preferred positions were sold as well as securities of a number of regional banks and other financial institutions. Most of this was accomplished prior to the Lehman bankruptcy in September 2008 when credit markets became even more disrupted. In addition, management reduced the aggregate sub-prime, Alt A, CMBS and CDO portfolio holdings significantly, through natural cash flows and certain opportunistic sales.

Results of portfolio simplification efforts included a reduction in exposure of $1.6 billion in the CMBS portfolio, as well as reducing the aggregate corporate portfolios by $1.2 billion during 2008. The Company also reduced its risk exposure to alternative investments by approximately $0.8 billion during 2008 in

response to
adverse market
conditions and
ongoing
efforts to
reduce the risk
within

its investment portfolio. As well, following the charge of $400.0 million recorded during the fourth quarter of 2008 relating to impaired assets that the Company could no longer assert its intent to hold to recovery, the Company expects to be able to accelerate its investment portfolio risk reduction exercise during 2009.

Management further reduced interest rate risk exposure during 2008 by shortening the duration of the portfolio supporting the U.S. property and casualty operations by 0.6 years. Cash and government agency holdings were increased by approximately $2.4 billion to approximately $13.2 billion representing approximately 41.2% of the fixed income portfolio at December 31, 2008.

Reduction of Expenses to Reflect Simplified Business: In light of the changes in business strategy noted above and in response to expense pressure from softening market conditions and other significant market events which impacted the Company throughout 2008, the Company implemented in the third quarter of 2008 and subsequently in the first quarter of 2009, expense reduction initiatives designed to streamline certain of its processes and functions and reduce the Company s expense across all major geographic locations, with primary emphasis on corporate functions. The Company recorded restructuring charges totaling $50.8 million during the year ended December 31, 2008. In 2009, the Company expects to record an additional $1.9 million of restructuring charges associated with the restructuring efforts announced in the third quarter of 2008 and approximately $60 million to $80 million associated with the restructuring efforts announced in the first quarter of 2009. Restructuring charges relate mainly to employee termination benefits as well as certain asset writeoffs and ceasing to use certain leased property.

Capital Management

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

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

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

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

Concurrent with the closing of the Master Agreement, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003 resulting in net proceeds to the Company of approximately

$500.0 million in exchange for the issuance by the Company of 20,000,000 redeemable Series C Preference Ordinary Shares. On February 27, 2009, the Company initiated a cash tender offer for all of the outstanding Series C Preference Shares. See Capital Resources below for further details relating to the redeemable Series C Preference Ordinary Shares.

In July 2008, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.19 per ordinary share beginning with the quarterly dividend paid in September 2008. In addition, in February 2009, the Board of Directors approved a further reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend payable in March 2009.

Following the settlement of the purchase contracts associated with the 7.0% Units in February 2009, the Company issued 11,461,080 Shares for net proceeds of approximately $743.1 million, which was used to retire the senior notes previously due February 2011 which had a fixed coupon of 5.25% (the 2011 Senior Notes).

Other capital management initiatives undertaken in 2008 included the following:

Upon expiration of the Company s quota share reinsurance treaty with Cyrus Re which reduced the Company s catastrophe exposures, the Company, effective January 1, 2008, entered into a quota share reinsurance treaty with a newly-formed Bermuda reinsurance company, Cyrus Re II. Pursuant to the terms of the quota share reinsurance treaty, Cyrus Re II assumed a 10% cession of certain lines of property catastrophe reinsurance and retrocession business underwritten by certain operating subsidiaries of the Company for business that incepted between January 1, 2008 and July 1, 2008. In connection with such cessions, the Company paid Cyrus Re II reinsurance premium less a ceding commission, which included a reimbursement of direct acquisition expenses incurred by the Company as well as a commission to the Company for generating the business. The quota share reinsurance treaty also provided for a profit commission payable to the Company. Following the Company s evaluation of its exposures and the current market conditions, Cyrus Re II was canceled and not renewed at December 31, 2008.

In the second quarter of 2008, the Company purchased additional reinsurance including several tranches of industry loss warranty contracts attaching at various levels. Such industry loss warranty contracts were short-term in nature and are not considered to be a permanent component of the Company s long-term risk management strategy. In relation to catastrophe risk management, the Company considers the loss of capital due to a single large event and the loss of capital that would occur from multiple (but potentially smaller) events in any given year. The Company imposes a limit to catastrophe risk from any single loss in a given region/peril at a 1% exceedance probability. The Company manages its limits to a catastrophe risk from a single loss in a given peril/region at a 1% exceedance probability. Tier 1 limits which include natural catastrophes and other realistic disaster scenarios are targeted at a level not to exceed 15% of tangible shareholders equity, where Tier 2 limits, which include pandemic, longevity and country risk, are established at no more than half of Tier 1 limits. These target limits are established by a combination of commercially available models, internally developed probable maximum loss estimates and the judgment of management.

In addition to the above noted key priorities of the Company, other key focuses of management during the year ended December 31, 2008 included the following:

Operational Transformation Program

In 2008, the Company announced the commencement of a multiple year operational transformation program (the Program) within the Company s Insurance segment that involved the planned transformation of numerous business processes and technology systems into a unified global architecture. However, in January 2009, following a review of this initiative and in light of the current economic climate, the Company refined the scope of the Program to focus on enhancing claims capabilities to strengthen and support the Insurance segment s global claims operations.

Evaluation of the Impact of Credit Market Volatility on Core Underwriting Operations

In addition to the evaluation of the impact of the distressed credit and sub-prime markets on the Company s investment portfolio, as discussed above, management has also completed detailed assessments of the exposure to these credit related issues in the core P&C insurance and reinsurance businesses, in particular the Insurance segment professional lines portfolio exposures through D&O and E&O policies. Actual policy notices as well as potential further notice activity that could arise from insureds that have been linked to sub-prime related matters are monitored on a monthly basis. Such notice activity is considered in establishing loss and loss expense reserves at each period end. In the Insurance segment, the Company has received a total of 56 policy notices associated with the 2007 report year and 71 policy notices associated with the 2008 report year. For 2007, 54% of gross limits are side-A and for 2008, 41% are side-A (direct coverage of directors and officers only).

During the reserve review process in the first quarter of 2008, the loss ratio for the 2008 reporting year was established to provide a provision for clash-type events such as the sub-prime crisis was increased by approximately 5 points over the 2007 clash loss ratio. This increase applied to standard professional lines including D&O, E&O and Fiduciary exposures where the sub-prime related notice activity has been concentrated. Notice activity during the remainder of 2008 was in line with expectations and no further adjustment was made to the loss ratio established in the first quarter. While loss reserves for professional lines in the 2007 and prior report years have developed favorably in the aggregate during 2008, it should be noted that included within this favorable development is strengthening of the 2007 report year reserves due to the uncertainty associated with sub-prime and credit-related notice activity.

Minor adjustments were made to the current year loss ratios and prior year reserves in the Reinsurance segment professional lines portfolio during the year ended December 31, 2008, reflecting updated claim activity. Such adjustments had less than a one point impact on the year-to-date loss ratio for the segment and the reserve strengthening in more recent underwriting years was more than offset by favorable development on older underwriting years within professional lines. Global credit events have also had an impact on the trade credit portfolio written in the European reinsurance operations and this is reflected in the 2008 loss ratios.

Foreign Exchange Exposure

In the normal course of business, the Company is exposed to foreign exchange fluctuations on various items on its financial statements, in particular investments, future policy benefit reserves and unpaid losses and loss expenses. This exposure also exists on certain inter-company balances, which are eliminated for consolidation purposes. The Company attempts to manage this economic exposure through matching foreign currency denominated liabilities with foreign currency denominated assets. While unrealized foreign exchange gains and losses on underwriting balances may be in certain instances reported in earnings, the offsetting unrealized gains and losses on invested assets are recorded as a separate component of shareholders equity, to the extent that the asset currency does not match that entity s functional currency. This results in an accounting mismatch that will result in foreign exchange gains or loss in the consolidated statements of income depending on the movement in certain currencies. Management continues to focus on attempting to limit this type of exposure in the future.

Critical Accounting Policies and Estimates

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

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

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

As the Company earns premiums for the underwriting risks it assumes, it also establishes an estimate of the expected ultimate losses related to the premium. Loss reserves or unpaid losses and loss expenses are established due to the significant periods of time that may lapse between the occurrence, reporting and settlement of a loss. The process of establishing reserves for unpaid property and casualty claims can be complex and is subject to considerable variability, as it requires the use of informed estimates and judgments. These estimates and judgments are based on numerous factors, and may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed or as current laws change. Loss reserves include:

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

(b) IBNR losses.

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

With respect to the Company s insurance operations, the Company is notified of insured losses and records a case reserve for the estimated amount of the settlement, if any. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of legal counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. With respect to the Company s reinsurance operations, case reserves for reported claims are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the estimated ultimate cost of a loss. The uncertainty in the reserving process for reinsurers is due, in part, to the time lags inherent in reporting from the original claimant to the primary insurer to the reinsurer. As a predominantly broker market reinsurer for both excess-of-loss and proportional contracts, the Company is subject to a potential additional time lag in the receipt of information as the primary insurer reports to the broker who in turn reports to the Company. As of December 31, 2008, the Company did not have any significant backlog related to its processing of assumed reinsurance information.

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

As noted above, case reserves for the Company s reinsurance operations are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the

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

While the reliance on loss reports from ceding companies may increase the level of uncertainty associated with the estimation of total loss reserves for property reinsurance relative to direct property insurance, there are several factors which serve to reduce the uncertainty in loss reserve estimates for property reinsurance. First, for large natural catastrophe events such as Hurricane Ike, aggregate limits in property catastrophe reinsurance contracts are generally fully exhausted by the loss reserve estimates. Second, as a reinsurer, the Company has access to information from a broad cross section of the insurance industry. The Company utilizes such information in order to perform consistency checks on the data provided by ceding companies and is able to identify trends in loss reporting and settlement activity and incorporate such information in its estimate of IBNR reserves. Finally, the Company also supplements the loss information received from cedants with loss estimates developed by market share techniques and/or from third party catastrophe models applied to exposure data supplied by cedants.

With respect to the Company s financial lines operations, financial guarantee claims incurred on policies written on an insurance basis are established consistent with the Company s insurance operations and financial guarantee claims incurred on policies written on a reinsurance basis are established consistent with the Company s reinsurance operations.

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

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

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

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

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

Over time, as a greater number of claims are reported, actuarial estimates of IBNR are based on the BF and loss development techniques. The BF method utilizes actual loss data and the expected patterns of loss emergence, combined with an initial expectation of ultimate losses to determine an estimate of ultimate losses. This method may be appropriate when there is limited actual loss data and a relatively less stable pattern of loss emergence. The chain ladder method utilizes actual loss and expected patterns of loss emergence to determine an estimate of ultimate losses that is independent of the initial expectation of ultimate losses. This method may be appropriate when there is a relatively stable pattern of loss emergence and a relatively larger number of reported claims. Multiple estimates of ultimate losses using a variety of actuarial methods are calculated for many, but not all, of the Company s (150+) classes of business for each year of loss experience. The Company s actuaries look at each class and determine the most appropriate point estimate based on the characteristics of the particular class and other relevant factors, such as historical ultimate loss ratios, the presence of individual large losses, and known occurrences that have not yet resulted in reported losses. Once the Company s actuaries make their determination of the most appropriate point estimate for each class, this information is aggregated and presented to management for review and approval.

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

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

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

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

(1) high layer excess casualty insurance;

(2) casualty reinsurance; and

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

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

High layer excess casualty insurance claims typically involve claims relating to (i) a shock loss such as an explosion or transportation accident causing severe damage to persons and/or property over a short period of time, (ii) a non-shock loss where a large number of claimants are exposed to injurious conditions over a longer period of time, such as exposure to chemicals or pharmaceuticals or (iii) a professional liability loss such as a medical malpractice claim. In each case, these claims are ultimately settled following extensive negotiations and legal proceedings. This process can typically take 5 to 15 years following the date of loss.

Reinsurance operations by their nature add further complications to the reserving process, particularly for casualty business written, in that there is an inherent lag in the timing and reporting of a loss event from an insured or ceding company to the reinsurer. This reporting lag creates an even longer period of time between the policy inception and when a claim is finally settled. As a result, more judgment is required to establish reserves for ultimate claims in the Company s reinsurance operations.

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

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

Discontinued asbestos and long-tail environment business had been previously written by NAC Re Corp. (now known as XL Reinsurance America Inc.), prior to its acquisition by the Company. As at December 31, 2008, total gross unpaid losses and loss expenses in respect of this business represented less than 1% of unpaid losses and loss expenses.

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

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

As noted above, management reviews the IBNR estimates produced by the Company s actuaries and determines its best estimate of the liabilities to record in the Company s financial statements. The Company considers this single point estimate to be one that has an equal likelihood of developing a redundancy or deficiency as the loss experience matures. Management believes that the actuarial methods utilized adequately provide for loss development.

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

The Company s net unpaid losses and losses expenses (excluding, in 2007, financial guarantee reserves related to reinsurance agreements with Syncora that are recorded within Net loss from operating affiliates) relating to the Company s operating segments at December 31, 2008 and 2007 was as follows:

(U.S. dollars in millions)	**December 31, 2008**	**December 31, 2007**
Insurance	$ 11,126	$ 11,138
Reinsurance	6,559	7,053
Net unpaid loss and loss expense reserves	$ 17,685	$ 18,191

(U.S. dollars in millions)	Net Unpaid Losses and Loss Expenses as at December 31, 2008 Case Reserves	IBNR Reserves	Total Reserves
Insurance			
Casualty professional lines.	$ 1,558	$ 2,764	$ 4,322
Casualty other lines	1,551	2,190	3,741
Property catastrophe (1)	9	14	23
Other property	482	119	601
Marine, energy, aviation, and satellite	635	534	1,169
Other specialty lines (2)	341	500	841
Other (3)	233	146	379
Structured Indemnity	(7)	57	50
Total	**$ 4,802**	**$ 6,324**	**$ 11,126**
Reinsurance			
Casualty (4)	$ 1,715	$ 2,427	$ 4,142
Property catastrophe (1)	157	148	305
Other property	535	427	962
Marine, energy, aviation, and satellite	443	72	515
Other (3)	256	301	557
Structured Indemnity		78	78
Total	**$ 3,106**	**$ 3,453**	**$ 6,559**
TOTAL	**$ 7,908**	**$ 9,777**	**$ 17,685**

(U.S. dollars in millions)	Net Unpaid Losses and Loss Expenses as at December 31, 2007 (5) Case Reserves	IBNR Reserves	Total Reserves
Insurance			
Casualty professional lines	$ 1,563	$ 2,386	$ 3,949
Casualty other lines	1,644	2,371	4,015
Property catastrophe (1)	22	28	50
Other property	406	154	560
Marine, energy, aviation, and satellite	649	558	1,207
Other specialty lines (2)	308	434	742
Other (3)	285	189	474

Structured Indemnity	54	87	141
Total	**$ 4,931**	**$ 6,207**	**$ 11,138**
Reinsurance			
Casualty (4)	$ 1,966	$ 2,642	$ 4,608
Property catastrophe (1)	122	131	253
Other property	543	447	990
Marine, energy, aviation, and satellite	488	33	521
Other (3)	297	296	593
Structured Indemnity		88	88
Total	**$ 3,416**	**$ 3,637**	**$ 7,053**
TOTAL	**$ 8,347**	**$ 9,844**	**$ 18,191**

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

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

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

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

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

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

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

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

The following table shows the recorded estimate and the high and low ends of the range of the Company s net unpaid losses and loss expenses (excluding, in 2007, financial guarantee reserves related to reinsurance agreements with Syncora that are recorded within Net loss from operating affiliates) for each of the lines of business noted above at December 31, 2008:

(U.S. dollars in millions)	Net Unpaid Losses and Loss Expenses Recorded as at December 31, 2008	Range of Net Unpaid Losses & Loss Expenses Estimated as at December 31, 2008 High	Range of Net Unpaid Losses & Loss Expenses Estimated as at December 31, 2008 Low
Insurance			
Casualty professional lines	$ 4,322	$ 4,828	$ 3,838
Casualty other lines.	3,741	4,221	3,284
Property catastrophe (1)	23	26	20
Other property	601	689	517
Marine, energy, aviation, and satellite.	1,169	1,260	1,080
Other specialty lines (2)	841	914	771
Other (3)	379	432	329
Total (5)	$ 11,076	$ 12,053	$ 10,131

Reinsurance						
Casualty (4)	$	4,142	$	4,554	$	3,759
Property catastrophe (1)		305		356		257
Other property		962		1,061		872
Marine, energy, aviation, and satellite.		515		591		445
Other (3)		557		646		479
Total (5)	$	6,481	$	7,005	$	5,989
Structured Indemnity (5)	$	128				
Total	$	17,685				

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

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

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

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

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

Actual development of recorded reserves as of December 31, 2007 during 2008 was within the estimated reserve range.

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

The Company s methodology in 2008 for calculating reserve ranges around its single point reserve estimate is consistent with that used in 2007. The Company modeled a statistical distribution of potential reserve outcomes over a one year run-off period for each of the approximately 35 lines of business. In doing so the Company evaluated a number of alternative models, and for each line of business the Company s actuaries selected the one deemed to be most appropriate. Factors affecting this decision included an assessment of the model fit, availability and relevance of data and the impact of changes in business mix. The Company used the modeled statistical distribution to calculate an 80% confidence interval for the potential reserve outcomes over this one year run-off period. The high and low end points of the ranges set forth in the above table are such that there is a 10% modeled probability that the reserve will develop higher than the high point and a 10% modeled probability that the reserve will develop lower than the low point.

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

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

During 2006, the Company reviewed the correlation assumptions between its various lines of business. There was growth in certain lines of business as well as changes in the groupings of the data used in the reserving process. These changes necessitated a review of the correlation matrix used to develop the Company s reserve ranges. The Company took a simplified approach of assigning ratings of low, medium or high to its correlation assumptions for each line of business pairing based on the judgment of the reserving actuaries, as there was both limited historical experience within its portfolio and limited applicable industry data. However, the Company s actual historical experience and industry data were used to judgmentally select a range of values for the low, medium and high correlations, respectively, of 15%, 30% and 50%. It should be noted that both the Company s own experience and the industry data exhibit negative correlations in reserve developments between certain lines of business. However, as a measure of prudence in evaluating the reserve ranges, the Company has used a minimum of 15% correlation between any two lines of business. The analysis of correlations and the reflection of potential diversification benefits across lines of business represent another area of uncertainty in the development of estimated reserve ranges.

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

See further discussion under Segments below for prior year development of loss reserves.

Financial Guarantee Loss Reserving

The Company had reserves for financial guarantee insurance contracts of $14.5 million and $427.4 million, respectively, recorded within Unpaid Losses and Loss Expenses , at December 31, 2008 and December 31, 2007, respectively. At December 31, 2007 the most significant financial guarantee exposures were related to the Company s reinsurance agreements with Syncora and its subsidiaries. Following the closing of the Master Agreement, the Company s financial guarantee exposures associated with Syncora were eliminated, with the exception of the guarantee of Syncora s obligations under certain policies with European Investment Bank which are not subject to FASB Statement of Financial Accounting Standards No. 163 Accounting for Financial Guarantee Insurance Contracts, an interpretation of FAS 60 (FAS 163), which is effective January 1, 2009.

As of December 31, 2008, the Company s outstanding financial guarantee contracts that were subject to FAS 163 included the reinsurance of 48 financial guarantee contracts with total insured contractual payments outstanding of $936.6 million ($798.5 million of principal and $138.1 million of interest) with a remaining weighted-average contract period of 7.9 years. The total gross claim liability and unearned premiums recorded at December 31, 2008 were $14.5 million and $3.1 million, respectively. Of the contractual exposure existing at December 31, 2008, the Company has reinsured $360.5 million with a third party. There are no gross claim liabilities or recoverables recorded relating to this exposure. Surveillance procedures to track and monitor credit deteriorations in the insured financial obligations are performed by the primary obligors for each transaction on the Company s behalf. Information regarding the performance status and updated exposure values is provided to the Company on a quarterly basis and evaluated by management in recording claims reserves. Of the 48 contracts noted above, 5 contracts with total insured contractual payments outstanding of $18.4 million had experienced an event of default and were considered by the Company to be non-performing at December 31, 2008, while the remaining 43 contracts were considered to be performing at such date.

Management establishes reserves for losses and loss adjustment expenses on such business based on management s best estimate of the ultimate expected incurred losses. The Company s estimated ultimate expected incurred losses are comprised of: (i) case basis reserves, (ii) unallocated reserves, and (iii) cumulative paid losses to date. Establishment of such reserves requires the use and exercise of significant judgment by management, including with respect to estimates regarding the occurrence and amount of a loss on an insured obligation. Estimates of losses may differ from actual results and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred. Examples of these events include changes in the level of interest rates, credit deterioration of insured obligations, and changes in the value of specific assets supporting insured obligations. Both qualitative and quantitative factors are used in establishing such reserves. In determining the reserves, management considers all factors in the aggregate, and does not attribute the reserve provisions or any portion thereof to any specific factor.

Any estimate of future costs is subject to the inherent limitation on the Company s ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and loss adjustment expenses will vary, perhaps materially, from any estimate.

The amount of the case basis reserve is based on the net present value of the expected ultimate loss and loss adjustment expense payments that the Company expects to make, net of expected recoveries under salvage and subrogation rights. Case basis reserves are determined using cash flow or similar models to estimate the net present value of the anticipated shortfall between (i) scheduled payments on the insured obligation plus anticipated loss adjustment expenses and (ii) anticipated cash flow from the proceeds to be received on sales of any collateral supporting the obligation and other anticipated recoveries. A number of quantitative and qualitative factors are considered when determining or assessing, in management s judgment, the need for a case basis reserve. These factors may include the creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured, the projected cash flow or market value of any assets that collateralize or secure the insured obligation, and the historical and projected loss rates on such assets. Other factors that may affect the actual ultimate loss include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral. Case basis reserves are generally discounted at a rate reflecting the yield on the Company s investment portfolio during the period the case basis reserve is established. The Company believes this yield is an appropriate rate to discount the Company s reserves because it reflects the rate of return on the assets supporting such business. When a case basis reserve is established for a guaranteed obligation whose premium is paid on an upfront basis, the Company continues to record premium earnings on such policy over its remaining life, unless it has recorded a full limit loss with respect to such policy, in which case the remaining deferred premium revenue relating thereto is immediately reflected in earnings. When a case basis reserve is established for a guaranteed obligation whose premium is paid on an installment basis, those premiums, if expected to be received prospectively, are considered a form of recovery netted against the loss reserves and are no longer earned as premium revenue.

In addition to case basis reserves, the Company maintains an unallocated loss reserve for expected losses inherent in the Company s in-force business (consisting of both financial guarantee insurance and reinsurance business) that is expected to emerge in the future. The unallocated loss reserves represent the Company s estimated ultimate liability from claims expected to be incurred in the future under in-force insured and reinsured policies less outstanding case basis reserves and cumulative paid claims to date on such policies.

Unpaid losses and loss expenses recoverable

The recognition of unpaid losses and loss expenses recoverable requires two key judgments. The first judgment involves the Company s estimation of the amount of gross IBNR to be ceded to reinsurers. Ceded IBNR is generally developed as part of the Company s loss reserving process and consequently, its estimation is subject to similar risks and uncertainties as the estimation of gross IBNR (see Critical Accounting Policies and Estimates Unpaid losses and loss expenses and unpaid loss and loss expense recoverable). The second judgment involves the Company s estimate of the amount of the reinsurance recoverable balance that the Company will ultimately be unable to recover from related reinsurers due to insolvency, contractual dispute, or for other reasons. Amounts estimated to be uncollectible are reflected in a bad debt provision that reduces the reinsurance recoverable balance and shareholders equity. Changes in the bad debt provision are reflected in net income. See Item 8, Note 13 to the Consolidated Financial Statements, Reinsurance , for further information.

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

2) Future Policy Benefit Reserves

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

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

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

The reserving methodology for these annuity portfolio reinsurance contracts is described in FASB Statement of Financial Accounting Standards No. 60 Accounting and Reporting by Insurance Enterprises (FAS 60), as amended by FASB Statement of Financial Accounting Standards No. 97 Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments (FAS 97). These contracts subject the Company to risks arising from policyholder mortality over a period that extends beyond the periods in which premiums are collected. Liabilities for future policy benefit reserves are established in accordance with the provisions of FAS 60.

Claims and expenses for individual policies within these annuity reinsurance contracts are projected over the lifetime of the contract to calculate a net present value of future cash flows. Assumptions for each element of the basis (mortality, expenses and interest) are determined at the issue of the contract and these assumptions are locked-in throughout the term of the contract unless a premium deficiency exists. The assumptions are best estimate assumptions plus provisions for adverse deviations on the key risk elements (i.e., mortality and interest). Provisions for adverse deviation are designed to cover reasonable deviations from the best estimate outcome of the contract. As the experience on the contracts emerges, the assumptions are reviewed. This occurs at least annually and includes both an analysis of experience and review of likely future experience. If such review would produce reserves in excess of those currently held then lock-in assumptions will be revised and a loss recognized. During the years ended December 31, 2008, 2007 and 2006, there were no adjustments to the locked-in assumptions for these annuity reinsurance contracts.

The future policy benefit reserves for these annuity portfolio reinsurance contracts amounted to $4.4 billion and $5.8 billion at December 31, 2008 and 2007 respectively. The Company holds the investment assets backing these liabilities. These investments are primarily fixed income securities with maturities that closely match the expected claims settlement profile. A 0.1% decrease in the investment yield assumption would result in approximately a $28 million increase in the value of future claims related to annuity portfolio reinsurance.

As stated above, the future policy benefit reserves include provisions for adverse deviation in excess of best estimate assumptions that amounted to approximately $178 million and $410 million at December 31, 2008 and 2007, respectively. The future policy benefit reserves would only be increased if these provisions for adverse deviation became insufficient in the light of emerging claims experience. The present value of future claims would increase by approximately $17 million if mortality rates were to decrease by 1% in all future years, relative to the reserving assumptions.

The Company also provides reinsurance of disability income protection, for an in-force block of business. The future policy benefit reserves for these contracts amounted to approximately $97 million and $90 million at December 31, 2008 and 2007, respectively. Future policy benefit reserves are established in accordance with the provisions of FAS 60, including the lock-in of assumptions at inception with periodic review against experience. The liabilities relate to in-force blocks of business, comprising underlying insurance policies that provide an income if the policyholder becomes sick or disabled. The liabilities are therefore driven mainly by the rates at which policyholders become sick (where sickness is defined by the policy conditions) and by the rates at which these policyholders recover or die. A 1% increase in the incidence rate would increase the value of future claims by approximately $1.6 million, while a 1% decrease in the termination rate would increase the value of future claims by approximately $3.0 million. While no changes to the locked-in assumptions were made in 2007, following a review of claim termination experience in 2008, the reserving assumptions were revised, resulting in a reduction in income of $10.0 million during the year.

The Company also provides reinsurance of term assurance and critical illness policies written in the U.K., Ireland and the US. The future policy benefit reserves for these contracts amounted to approximately $279 million and $242 million at December 31, 2008 and 2007, respectively. Future policy benefit reserves are established in accordance with the provisions of FAS 60, including the lock-in of assumptions at inception with periodic review against experience. The provisions for adverse deviation in these reserves amounted to approximately $25 million and $22 million at December 31, 2008 and 2007, respectively.

The liabilities relate to in-force blocks of business and to treaties accepting new business, comprising underlying insurance policies that provide mainly lump sum benefits if the policyholder dies or becomes sick. For term assurance, the liabilities are therefore driven by the rates of mortality and for critical illness cover, the liabilities are driven predominantly by the rates at which policyholders become sick, where sickness is defined by the treaty conditions (i.e., the morbidity rates). A 1% increase in the mortality rate relative to the reserving assumption would increase the value of future claims by approximately $2.5 million, and a 1% increase in the morbidity rate would increase the value of future claims by approximately $2.0 million.

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

The Company also provided reinsurance of a block of U.S. based term assurance, which was novated to the Company from an insurance affiliate in December 2002. The future policy benefit reserves for these contracts amounted to approximately $254 million and $245 million at December 31, 2008 and 2007, respectively. Future policy benefit reserves are established in accordance with the provisions of FAS 60, including the lock-in of assumptions at inception with periodic review against experience.

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

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

3) Deposit Liabilities

The Company s deposit liabilities at December 31, 2008 reflect obligations assumed under funding agreements, payment undertaking agreements and certain structured insurance and reinsurance agreements. Previously, deposit liabilities included GICs; however, based on the terms and conditions of the underlying GICs, upon the downgrade of Syncora Guarantee below certain ratings levels, all or portions of outstanding principal balances on such GICs would come due. Throughout 2008, several rating agencies downgraded Syncora and its subsidiaries and as a result, the Company settled, during 2008, all of the GIC liabilities. For existing deposit liability contracts at December 31, 2008, the Company establishes a deposit liability equal to the net cash received at inception. Each deposit liability accrues at a rate equal to the internal rate of return of the payment receipts and obligations due during the life of the agreement. Where the timing and/or amount of future payments are uncertain, cash flows reflecting the Company s actuarially determined best estimates are utilized. The ultimate size of underlying losses, the impact of the contractual limits upon settlement of such losses, and the impact of the underlying loss settlement process on the timing of payments are considered as appropriate. Where uncertainty is present, an increase in the ultimate claims cost or accelerated claims settlement would potentially lead to an increase in the deposit liability accretion rate or lead to incurred losses if significant. The interest expense reported due to the accretion of deposit liabilities associated with structured insurance and reinsurance contracts was $74.8 million, $76.6 million and $37.8 million for the years ended December 31, 2008, 2007 and 2006, respectively. For some of the Company s deposit liabilities, the accretion rate is recorded at its contractual maximum level. For all other contracts, a 1% increase in the average accretion rate would result in an increase in deposit liabilities and interest expense by $23.7 million on an annualized basis. See Item 8, Note 14 to the Consolidated Financial Statements, Deposit Liabilities.

4) Derivative Instruments

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

a) Credit Derivatives

Credit derivatives are purchased within the Company s investment portfolio, have been sold through a limited number of contracts written as part of the Company s previous XL Financial Solutions business, and were previously entered into through the Company s prior reinsurance agreements with Syncora, as described below. From time to time, the Company may purchase credit default swaps to hedge an existing position or concentration of holdings. The credit derivatives are recorded at fair value. Following the secondary sale of Syncora common shares, the Company retained some credit derivative exposures written by Syncora and certain of its subsidiaries through reinsurance agreements that had certain derivatives exposures embedded within them. Subsequent to June 6, 2007, the Company received Syncora related derivative fair values from Syncora management and reviewed the methodology applied in developing those estimates. In addition, the change in value of the derivative portion of the financial guarantee reinsurance agreements the Company had with Syncora was included in Net (loss) income from operating affiliates. Following the closing of the Master Agreement which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreements. As of December 31, 2008, the remaining credit derivative exposure outside of the Company s investment portfolio consisted of 23 contracts written by the Company that provide credit protection on senior tranches of structured finance transactions with total net par values outstanding of $639.5 million, a weighted average contractual term to maturity of 5.7 years, a total liability recorded of $28.6 million, and an average rating of AA on the underlying obligations. As of December 31, 2008, there have been no reported events of default on the underlying obligations.

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

b) Weather and Energy Derivatives

The fair value of previously written weather and energy derivatives is determined through the use of quoted market prices where available. Where quoted market prices are unavailable, the fair value is estimated using available market data and internal pricing models using consistent statistical methodologies. Estimating fair value of instruments that do not have quoted market prices requires management s judgment in determining amounts that could reasonably be expected to be received from, or paid to, a third party in settlement of the contracts. The amounts could be materially different from the amounts that might be realized in an actual sale transaction. Fair values are subject to change in the near-term and reflect management s best estimate based on various factors including, but not limited to, actual and forecasted weather conditions, changes in commodity prices, changes in interest rates and other market factors. See Item 7A, Quantitative and Qualitative Disclosures About Market Risk for sensitivity analysis and Item 8, Note 17 to the Consolidated Financial Statements, Derivative Instruments.

5) Other Than Temporary Declines in Investments

The Company s process for identifying declines in the fair value of investments that are other than temporary involves consideration of several factors. These primary factors include (i) the time period during which there has been a significant decline in value, (ii) an analysis of the liquidity, business prospects and financial condition of the issuer, (iii) the significance of the decline, (iv) an analysis of the collateral structure and other credit support, as applicable, of the securities in question, (v) expected future interest rate movements, and (vi) the Company s intent and ability to hold the investment for a sufficient period of time for the value to recover. In addition, EITF 99-20 requires that OTTI for certain asset backed and mortgage backed securities are recognized if the fair value of the security is less than its cost or amortized cost and there has been a decrease in the present value of the expected cash flows since the last reporting period. Where the Company s analysis of the above factors results in the Company s conclusion that declines in fair values are other than temporary, the cost of the security is written down to fair value and the previously unrealized loss is therefore realized in the period such determination is made.

With respect to securities where the decline in value is determined to be temporary and the security s value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of overall risk monitoring, changing information, market conditions generally and assessing value relative to other comparable securities. Day-to-day management of the Company s investment portfolio is outsourced to third party investment managers. While these investment managers may, at a given point in time, believe that the preferred course of action is to hold securities with unrealized losses that are considered temporary until such losses are recovered, the dynamic nature of the portfolio management may result in a subsequent decision to sell the security and realize the loss, based upon a change in market and other factors described above. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the Company s portfolio as available for sale.

As mentioned above, the Company considers its intent and ability to hold a security until the value recovers as part of the process of evaluating whether a security s unrealized loss represents an other than temporary decline. Management reviews any significant sales of securities for a loss to determine if such sale impacts the assertion with respect to the intent and ability to hold to recovery. For further details on management s assessment of OTTI, see Item 8, Note 9 to the Consolidated Financial Statements, Investments. However, this factor on its own does not dictate whether or not the Company recognizes an impairment charge. The Company believes its ability to hold such securities is supported by positive and sufficient cash flow from its operations and from maturities within its investment portfolio in order to meet its claims payment obligations arising from its underwriting operations without selling such investments. In this regard, cash flow from operating activities, excluding the payment to Syncora under the Master Agreement, was $1.3 billion and $2.2 billion in 2008 and 2007, respectively.

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

6) Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company had capitalized net operating tax losses of $301.3 million and $396.9 million against which a valuation allowance of $224.3 million and $204.4 million at December 31, 2008 and 2007, respectively, was established. The Company had capitalized realized and unrealized capital losses of approximately $196.3 million and $134.6 million, respectively, against which a valuation allowance of approximately $327.4 million at December 31, 2008 was established. Included within the capitalized realized losses are $173.7 million of losses arising from the sale of investments to a group company, against which a valuation allowance of $173.7 million has been established. The deferral of benefits from tax losses is evaluated based upon management s estimates of the future profitability of the Company s taxable entities based on current forecasts, the character of income and the period for which losses may be carried forward. A valuation allowance may have to be established for any portion of a deferred tax asset that management believes will not be realized. Should the future income of these entities fall below expectations, a further valuation allowance would have to be established, which could be significant. In addition, if any further losses are generated by these entities, these losses may not be tax affected.

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

7) Goodwill and Other Intangible Assets

The Company has recorded goodwill in connection with various acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with FASB Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142), the Company tests goodwill for potential impairment annually as of June 30 and between annual tests if an event occurs or circumstances change that may indicate that potential exists for the fair value of a reporting unit to be reduced to a level below its carrying amount. The Company tests for impairment at the reporting unit level, which is generally one level below its business segments. The Company evaluates goodwill for impairment using the two-step process prescribed in FAS 142. The first step is to identify potential impairment by comparing the fair value of a reporting unit to the estimated book value, including goodwill. The fair value of each reporting unit is derived based upon valuation techniques and assumptions the Company believes market participants would use to value the business. The estimated fair values of the reporting units are generally determined utilizing methodologies that incorporate discounted cash flow analyses, price-to-net- tangible-book, and price-to-earnings multiples of certain comparable companies. The Company derives the net book value of its reporting units by estimating the amount of shareholders equity required to support the activities of each reporting unit. If the estimated fair value of a reporting unit exceeds the estimated book value, goodwill is not considered impaired. If the book value exceeds the estimated fair value, the second step of the process is performed to measure the amount of impairment.

The Company completed its annual goodwill impairment testing, as of June 30, 2008 and June 30, 2007, which did not result in any goodwill impairment. However, due to the financial market and economic events that occurred in the fourth quarter of fiscal 2008, the Company performed an interim impairment test for goodwill subsequent to its annual testing date of June 30. The interim impairment test resulted in a non-cash goodwill impairment charge of $990.0 million. The charge relates primarily to certain reinsurance units goodwill associated with the merger of Mid Ocean in 1998. The fair value of the Mid Ocean reporting unit was calculated using the methodologies noted above and by comparison with similar companies using their publicly traded price multiples as the basis for valuation.

Other intangible assets include licenses of certain subsidiaries of the Company in various jurisdictions that allow such subsidiaries to write insurance and/or reinsurance business. These intangible assets are carried at or below estimated fair value and consistent with goodwill, are tested on an annual basis for impairment, or more frequently, if circumstances indicate that a possible impairment has occurred. Consistent with goodwill, there are many assumptions and estimates underlying the fair value calculation. Principally, the Company identifies the business entity that the intangible asset is attributed to, and reviews historical and forecasted performance and other underlying factors affecting such analysis, including market conditions, premium rates and loss trends. Other assumptions used could produce a significantly different result which may result in a change in the value of the intangible asset and related amortization charge in the Consolidated Statement of Income. Based on the current expectations of profitability, an impairment charge would only be recognized in the event of a significant decline in the expected profitability of those operations where such intangible assets are applicable.

After recording the impairments as described above, the Company has goodwill of $824.8 million remaining as at December 31, 2008, of which $426.7 million relates to the Company s Insurance segment while $398.1 million relates to the Company s Reinsurance segment.

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

8) Reinsurance Premium Estimates

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

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

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

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

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

The amount of premiums receivable related to the Company s reinsurance operations amounted to $1.7 billion as at December 31, 2008.

A significant portion of amounts included as premiums receivable, which represent estimated premiums written, net of commissions, are not currently due based on the terms of the underlying contracts. Management reviews the premiums receivable balance at least quarterly and provides a provision for amounts deemed to be uncollectible. The Company recorded a provision for uncollectible premiums receivable related to its reinsurance operations at December 31, 2008 of $19.0 million.

The amount of proportional and excess of loss reinsurance gross premiums written and gross acquisition expenses recognized by the Company s reinsurance operations for each line of business for the years ended December 31, 2008, 2007 and 2006 was as follows:

	December 31, 2008		December 31, 2007		December 31, 2006	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisitio Expenses**
Proportional Contracts:						
Property catastrophe	$	$	$	$	$	$
Casualty other lines	47,791	16,777	133,444	52,062	370,780	59,2
Casualty professional lines	62,268	20,772	47,361	23,413	58,533	46,7
Other property	745,244	148,066	739,130	201,170	774,984	205,3
Marine, energy, aviation and satellite	32,935	14,101	47,359	14,981	56,866	11,0
Other (1)	197,418	25,339	222,374	37,177	340,122	72,6
Structured Indemnity						
Total Proportional contracts	$ 1,085,656	$ 225,055	$ 1,189,668	$ 328,803	$ 1,601,285	$ 395,1

	December 31, 2008		December 31, 2007		December 31, 2006	
(U.S. dollars in thousands)	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisition Expenses**	**Gross Premiums Written**	**Gross Acquisitior Expenses**
Excess of loss Contracts:						
Property catastrophe	$ 401,740	$ 30,688	$ 475,540	$ 46,621	$ 449,312	$ 39,36
Casualty other lines	308,932	50,565	409,807	69,133	289,674	6,81

Casualty professional lines	151,251	29,696	208,919	45,476	239,429	84,06
Other property	202,655	18,096	231,066	21,724	274,875	21,36
Marine, energy, aviation and satellite	86,658	9,191	103,189	11,121	120,061	13,00
Other (1)	22,914	8,792	17,044	2,956	20,216	2,53
Structured Indemnity	671	2,699	28,261	374	71,286	64
Total Excess of loss contracts	$ 1,174,821	$ 149,727	$ 1,473,826	$ 197,405	$ 1,464,853	$ 167,78

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

Segments

The Company is organized into four operating segments: Insurance, Reinsurance, Life Operations, and Other Financial Lines in addition to a Corporate segment that includes the general investment and financing operations of the Company. The Company s Insurance and Reinsurance segments are sometimes collectively referred to as property and casualty or P&C operations.

The Company evaluates the performance for both the Insurance and Reinsurance segments based on underwriting profit and evaluates the contribution from each of the Life Operations and Other Financial Lines segments. 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 operations. Investment assets related to (i) the Company s Life Operations and Other Financial Lines segments and (ii) certain structured products included in the Insurance and Reinsurance segments are held in separately identified portfolios. As such, net investment income from these assets is included in the contribution from each of these segments.

Income Statement Analysis

Insurance

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

(U.S. dollars in thousands)	**2008**	**% Change 08 vs 07**	**2007**	**% Change 07 vs 06**	**2006**
Gross premiums written	$ 5,308,914	(2.3)%	$ 5,434,266	(3.4)%	$ 5,627,293
Net premiums written	3,984,826	(4.8)%	4,186,855	0.1 %	4,185,372
Net premiums earned	3,997,045	(2.9)%	4,116,588	(1.0)%	4,159,323
Fee income and other	42,548	NM *	11,812	(51.6)%	24,425
Net losses and loss expenses.	2,733,344	5.3 %	2,594,812	(4.8)%	2,726,847
Acquisition costs	465,044	(3.9)%	484,014	(2.7)%	497,367
Operating expenses	734,749	7.6 %	683,108	6.7 %	640,470
Underwriting profit	$ 106,456	(71.0)%	$ 366,466	14.9 %	$ 319,064
Exchange (gains) losses	$ (28,815)	NM *	$ 29,567	(78.9)%	$ 140,248
Net results structured products	$ (14,713)	NM *	$ (2,480)	NM *	$ 6,895

* NM Not Meaningful

Gross premiums written decreased by 2.3% during the year ended December 31, 2008 compared with 2007, primarily as a result of continued decreases in premium rates as market conditions continued to soften, a reduction in long-term agreements in late 2008, selective non-renewals and to a lesser extent, lost business opportunities associated with rating agency downgrades that occurred in 2008. Such decreases in gross premiums written were primarily within casualty and professional lines of business as well as certain specialty lines including environmental, aerospace and marine portfolios. Partially offsetting these decreases was growth in certain property lines, particularly in the construction book in Europe, as well as excess and surplus and middle market lines and favorable foreign exchange rate movements totaling $108.4 million. Net premiums written decreased by 4.8% during the year ended December 31, 2008 as compared to 2007 primarily as a result of the decrease in gross premiums written described above coupled with an increase in ceded premiums written associated with growth in certain property lines, change in the mix of business including an increase in long-term agreements with higher cession ratios, the impact from the purchase of an adverse development cover associated with a Company owned Lloyd s syndicate and unfavorable foreign exchange rate impacts of $29.6 million.

Gross premiums written decreased by 3.4% during the year ended December 31, 2007 compared with the year ended 2006, while net premiums written increased slightly during the same period. Decreases in gross premiums written were due primarily to a combination of a decrease in rates, reduced shares and selective non-renewals in certain property and marine lines of business, as well as the runoff of certain property catastrophe exposures. Partially offsetting these decreases was growth in the excess and surplus book of business in the U.S., increases in the number of long-term agreements, strong new business and higher renewal retentions within certain casualty lines of business, and favorable foreign exchange rate movements. Net premiums written increased slightly as the reduction in ceded premiums written was mostly offset by the reduction in gross premiums written noted above. Ceded premiums written decreased as a result of favorable outward reinsurance pricing conditions, increased retention related to certain captive programs and marine and energy treaties, as well as refunds associated with property catastrophe programs. Partially offsetting the decrease in ceded premiums was the impact of return premium associated with the commutation of ceded reinsurance policies in professional lines of business in 2006.

Net premiums earned decreased by 2.9% in 2008 as compared 2007 and by 1.0% in 2007 as compared to 2006. These decreases were primarily a reflection of the overall reduction of net premiums written over the last 12 to 24 months.

Fee income increased in 2008 as compared to 2007 mainly as a result of higher engineering fee revenue associated with XL GAPS, which formed in late 2007 following the acquisition of GAPS, a loss prevention consulting service provider. Fee income and other decreased in 2007 as compared to 2006, primarily due to a favorable legal settlement recorded in 2006 in relation to a U.K. contract as well as certain foreign exchange adjustments recorded in 2006.

The following table presents the ratios for the Insurance segment for each of the last three years ended December 31:

	2008	**2007**	**2006**
Loss and loss expense ratio	68.4 %	63.0 %	65.6 %
Underwriting expense ratio	30.0 %	28.4 %	27.4 %
Combined ratio	98.4 %	91.4 %	93.0 %

The loss and loss expense ratio noted above includes net losses incurred for both the current year and any favorable or adverse prior year development of loss and loss expense reserves held at the beginning of the year.

The following table summarizes the net (favorable) adverse prior year development by line of business relating to the Insurance segment for the last three years ended December 31:

(U.S. dollars in millions)		**2008**		**2007**		**2006**
Property	$	(106.0)	$	(95.0)	$	(94.4)
Casualty and Professional		(214.1)		(139.1)		5.4
Specialty and Other		9.6		76.0		75.8
Structured Indemnity		5.0				
Total	$	(305.5)	$	(158.1)	$	(13.2)
Loss and loss expense ratio excluding prior year development		76.0 %		66.9 %		65.9 %

In addition, the following tables present the prior year (favorable) adverse development of the Company s gross and net loss and loss expense reserves within the Insurance segment for the last three years ended December 31:

Gross:

(U.S. dollars in millions)	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 14,856	$ 14,528	$ 14,756
Net (favorable) adverse development of those reserves during the year	(610)	(178)	(371)
Unpaid losses and loss expense reserves re-estimated one year later	$ 14,246	$ 14,350	$ 14,385

Net:

(U.S. dollars in millions)	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 11,138	$ 10,608	$ 9,950
Net (favorable) adverse development of those reserves during the year	(305)	(158)	(13)
Unpaid losses and loss expense reserves re-estimated one year later	$ 10,833	$ 10,450	$ 9,937

Excluding prior year development, the loss ratio for the year ended December 31, 2008 increased by 9.1 loss percentage points as compared to 2007 with 2.6 points of the loss ratio increase attributable to a higher level of catastrophe losses in the current year, including the impacts of Hurricanes Ike and Gustav, which resulted in net incurred losses in the Company s Insurance segment of $54.0 million and $10.4 million, respectively, net of reinsurance recoverables and reinstatement premiums. The remainder of the increase in loss ratio was attributable to an increase in loss activity in property, loss activity anticipated for professional lines related to sub-prime and related credit events, premium adjustments booked in the third and fourth quarters as well as the softening rate environment impacting most lines of business.

Net favorable prior year development in the year ended December 31, 2008, totaled $305.5 million, primarily due to reserve releases in certain casualty lines primarily in 2003 to 2006 accident years due to lower than expected reported loss activity and favorable reserve development in global property lines of business as a result of favorable claim development. In addition, net reserve releases resulted from an agreement with Axa/Winterthur of approximately $80.9 million in the fourth quarter of 2008 in regards to certain reinsurance recoverable balances relating to casualty lines and to a lesser extent, certain property lines of business. Offsetting this favorable development was modest reserve strengthening within specialty lines, primarily in the environmental lines of business, as well as strengthening associated with certain structured indemnity contracts. Within the professional lines, reserve releases in the 2003 to 2006 accident years were largely offset by strengthening of reserves in the 2007 year. Gross prior year favorable development for the year ended December 31, 2008 of $609.6 million exceeded the corresponding net favorable development during the same period of $305.5 million, as the impact of reductions in gross reported losses on older years in certain casualty lines was mostly offset by the impact of the reinsurance recoverable component on such losses. In addition, the impact of gross reserve releases in professional and specialty lines was mostly offset by the impact of a reduction in estimated ceded IBNR following reserve reviews in these lines.

For the year ended December 31, 2007, net prior year reserve releases in the Insurance segment consisted of $95.0 million in property and $162.1 million in casualty lines of business, partially offset by net adverse development of $23.0 million, $7.0 million and $69.0 million in certain professional, marine and other lines of business, respectively. Casualty releases relate primarily to the European casualty portfolio in accident years 2002-2005. The professional lines development reflects net adverse prior year development of the Bermuda E&O portfolio and releases from the U.S. and European professional lines portfolios. Strengthening in other insurance lines relates to adverse development in discontinued specialty lines, surety and environmental, partially offset by favorable development in aerospace and political risk. Gross prior year development was also favorable at $177.6 million. Excluding prior year development, the loss ratio increased by 1.0 point partly due to an increase in attritional and catastrophe-related property experience and partly due to softening market conditions primarily in certain specialty lines.

The increase in the underwriting expense ratio in the year ended December 31, 2008, compared to 2007, was due to an increase in the operating expense ratio of 1.8 points (18.4% as compared to 16.6%) and partially offset by a decrease in the acquisition expense ratio of 0.2 points (11.6% as compared to 11.8%). The increase in the operating expense ratio was mainly as a result of a higher headcount which increased compensation, increases in professional fees and the impact of employee termination benefits recorded in the latter half of 2008, against lower net premiums earned. The increase in headcount and professional fees both supported new segment initiatives as well as the formation of XL GAPS in late 2007. Offsetting these increases in 2008 were decreases in performance related compensation. The acquisition expense ratio decreased mainly due to a reduction in foreign excise taxes as a result of a decrease in the cession percentage of an internal quota share from 75% to 50%, lower guarantee fund assessments and the impact of changes in the mix of business written.

The increase in the underwriting expense ratio in the year ended December 31, 2007, compared to the same period in 2006 was due to an increase in the operating expense ratio of 1.2 points (16.6% as compared to 15.4%), partially offset by a decrease in the acquisition expense ratio of 0.2 points (11.8% as compared to 12.0%). The increase in the operating expense ratio was due primarily to higher compensation costs associated with higher head count and corporate allocations, and was partially offset by adjustments booked in 2007 relating to previously accrued regulatory costs. The decrease in the acquisition expense ratio resulted primarily from an increase in outward reinsurance profit commissions as well as favorable prior year premium adjustments. Offsetting these decreases was the impact of a reduction in certain ceded brokerage costs in 2006.

Foreign exchange gains in the year ended December 31, 2008 and foreign exchange losses in the years ended December 31, 2007 and 2006 were due primarily to the change in the value of the U.S. dollar against certain European currencies including the U.K. Sterling and the Euro on certain inter-company balances.

Net results from structured insurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Results from these contracts for the year ended December 31, 2008, decreased compared to the same period in 2007 mainly due to lower net investment income and higher operating expenses, partially offset by lower interest expense. Net investment income decreased as a result of lower yields earned on investment income while operating expenses increased as a result of costs recorded in the latter half of 2008 associated with employee termination benefits relating to the closure of the XLFS business unit as noted above. Interest expense decreased mainly due to negotiated cancellation of certain contracts in 2008 that resulted in gains totaling $16.3 million and was partially offset by an accretion adjustment recorded during the same period, based on changes in expected cash flows on a structured indemnity contract. Results from these contracts for the year ended December 31, 2007, decreased compared to the same period in 2006 due to an unfavorable accretion adjustment recorded in 2007 based on changes in expected cash flows and the accelerated earnings recorded in 2006 resulting from a commutation. Offsetting these decreases in 2007 was higher net investment income as a result of higher yields and overall larger investment asset balances.

Reinsurance

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

(U.S. dollars in thousands)	**2008**	**% Change 08 vs 07**	**2007**	**% Change 07 vs 06**	**2006**
Gross premiums written	$ 2,260,477	(15.1)%	$ 2,663,494	(13.1)%	$ 3,066,138
Net premiums written	1,753,467	(16.9)%	2,110,865	(11.5)%	2,384,340
Net premiums earned	1,993,206	(13.4)%	2,302,039	(10.5)%	2,570,959
Fee income and other	9,260	NM *	1,698	(63.1)%	4,597
Net losses and loss expenses	1,229,554	(1.2)%	1,244,764	(14.7)%	1,459,309
Acquisition costs	383,136	(20.5)%	482,024	(5.7)%	511,133
Operating expenses	189,027	(8.2)%	205,966	8.1 %	190,545
	$ 200,749	(45.9)%	$ 370,983	(10.5)%	$ 414,569

Underwriting profit					
Exchange (gains)	(170,153)	NM *	(48,219)	12.4 %	(42,894)
Net results structured products	25,694	0.7 %	25,520	(29.5)%	36,218

* NM Not meaningful

Gross and net premiums written decreased by 15.1% and 16.9%, respectively, in the year ended December 31, 2008 as compared to the same period in 2007. These decreases resulted from the Company declining business due to competitive pressures continuing to drive certain rates below the Company s acceptable underwriting return levels together with increased client retentions. Partially offsetting these decreases in gross premiums written were favorable foreign exchange rate movements of $55.0 million and increases of $118.4 million associated with a U.S. agricultural program whose rates are tied to commodity prices, which have increased in 2008. Ceded premiums written decreased mainly as a result of the impact of a reduction in property catastrophe cessions to Cyrus Re II of 10% in 2008 as compared to a 35% cession to Cyrus Re throughout 2007, partially offset by ceded premiums totaling $23.3 million associated with the purchase of additional catastrophe loss protection in the form of industry loss warranty covers. However, the overall ceded ratio increased mainly due to lower net retention in 2008 as compared to 2007, mainly due to higher cession ratios associated with the U.S. agricultural program noted above, causing net premiums written to decrease at a higher percentage than gross premiums written.

Gross and net premiums written decreased by 13.1% and 11.5%, respectively, during the year ended December 31, 2007 as compared with the year ended December 31, 2006. These decreases resulted from the Company declining business due to competitive pressures continuing to drive certain rates below the

Company s acceptable underwriting levels as well as certain favorable reinstatement premium and U.S. property program adjustments recorded in 2006. For the year ended December 31, 2007, premium rate decreases were most significant in certain casualty and non-U.S. property lines of business. Net premiums written reflect the above changes in gross premiums written, combined with a reduction in ceded premiums in 2007 as compared to 2006 as a result of higher retentions and a lower cost of external retrocession.

Net premiums earned in the year ended December 31, 2008 decreased 13.4% as compared to the same period in 2007. Net premiums earned in the year ended December 31, 2007 decreased 10.5% as compared to the same period in 2006. The decrease in both 2008 and 2007 was a reflection of the overall reduction of net premiums written over the last three years.

Fee income increased by $7.6 million during 2008 as compared to 2007 mainly as a result of fees associated with capacity utilization with certain Lloyd s syndicates.

The following table presents the ratios for the Reinsurance segment for the last three years ended December 31:

	2008	**2007**	**2006**
Loss and loss expense ratio	61.7 %	54.1 %	56.8 %
Underwriting expense ratio	28.7 %	29.8 %	27.3 %
Combined ratio	90.4 %	83.9 %	84.1 %

The loss and loss expense ratio includes net losses incurred in the current year and any favorable or adverse prior year development of loss reserves held at the beginning of the year.

The following table summarizes the net (favorable) adverse prior year development by line of business relating to the Reinsurance segment for the last three years ended December 31:

(U.S. dollars in millions)	**2008**	**2007**	**2006**
Property and other short-tail lines	$ (138.4)	$ (188.7)	$ (133.0)
Casualty and other	(166.8)	(87.4)	7.3
Structured Indemnity		8.8	28.3
Total	$ (305.2)	$ (267.3)	$ (97.4)
Loss and loss expense ratio excluding prior year development	77.0 %	65.7 %	60.6 %

In addition, the following tables present the prior year (favorable) adverse development of the Company s gross and net loss and loss expense reserves within the Reinsurance segment for the last three years ended December 31:

Gross:

(U.S. dollars in millions)	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 8,001	$ 8,193	$ 8,704
Net (favorable) adverse development of those reserves during the year	(444)	(260)	(18)
Unpaid losses and loss expense reserves re-estimated one year later	$ 7,557	$ 7,933	$ 8,686

Net:

(U.S. dollars in millions)	**2008**	**2007**	**2006**
Unpaid losses and loss expense reserves at the beginning of the year	$ 7,053	$ 7,138	$ 7,112
Net (favorable) adverse development of those reserves during the year	(305)	(267)	(98)
Unpaid losses and loss expense reserves re-estimated one year later	$ 6,748	$ 6,871	$ 7,014

Excluding prior year development, the loss ratio for the year ended December 31, 2008 increased by 11.3 loss percentage points as compared to the same period in 2007 with 7.7 points attributable to an increase in catastrophe losses occurring during 2008 (12.0 points in 2008 versus 4.3 points in 2007), mainly as a result of the impacts of Hurricanes Ike and Gustav, which resulted in net incurred losses in the Company s Reinsurance segment of $155.9 million and $12.1 million, respectively, net of reinsurance recoverables and reinstatement premiums. The remaining increase of 3.6 loss ratio points was attributable to the softening rate environment, higher attritional property losses and higher anticipated loss activity in the professional and trade credit portfolios.

For the year ended December 31, 2008, net favorable prior year reserve development included casualty and other lines reserve releases in both European and U.S. casualty and professional portfolios as well as reserve releases associated with the reinsurance-to-close relating to the 2005 year of account on certain Lloyd s sourced business. In the same period, property and other short-tail lines net favorable development was attributable to most business units globally. Gross prior year favorable development for the year ended December 31, 2008 of $444.3 million exceeded the corresponding net favorable development during the same period of $305.2 million as the impact of favorable loss experience related to a large crop program was mostly offset by the impact of retrocession protection related to this program.

Within the Reinsurance segment, reserve releases of $188.7 million during the year ended December 31, 2007 primarily in property and other short-tail lines of business and $87.4 million in casualty and other lines, was partially offset by adverse prior year development of $8.8 million within the structured indemnity line of business. Releases in the short-tail lines relate primarily to the 2005 and 2006 accident years. The casualty and other lines favorable development of $87.4 million reflects the net result of releases of $121.4 million primarily in the U.S. and non-U.S. casualty portfolios, partially offset by net adverse development of $13.0 million associated with the results of an external review of the Company s asbestos and environmental reserves and $21.0 million related to a commutation of a stop loss reinsurance agreement. Favorable gross prior year development of $259.7 million was in line with the net development. Excluding prior year development, the loss ratio for the year ended December 31, 2007 increased by 5.1 loss percentage points as compared to the same period in 2006 as a result of higher attritional losses within the property risk book of business as well as losses recorded relating to certain catastrophe losses including European windstorms Kyrill and Per/Hanno, California wildfires and the Peru earthquake.

The decrease in the underwriting expense ratio in the year ended December 31, 2008, as compared with the same period in 2007, was due to a decrease in the acquisition expense ratio of 1.7 points (19.2% compared to 20.9%) and was partially offset by an increase in the operating expense ratio of 0.6 points (9.5% compared to 8.9%). The decrease in the acquisition expense ratio was primarily due to a favorable variance in performance-related commissions in 2008 as compared to 2007. Although operating expenses were lower in the year ended December 31, 2008 as compared to the same period in 2007, the lower level of net premiums earned as noted above caused an increase in the operating expense ratio. The decrease in operating expenses was mainly as a result of a bad debt provision and higher performance related compensation expenses both recorded in 2007 and was partially offset by the impact in 2008 of costs associated with the Company s restructuring activities as well as administrative expenses associated with the expansion of the Company s reinsurance operations in Brazil.

The increase in the underwriting expense ratio in the year ended December 31, 2007, as compared with the year ended December 31, 2006, was due to an increase in both operating expense and acquisition expense ratios to 8.9% and 20.9%, respectively, as compared with 7.4% and 19.9%, respectively, in the year ended December 31, 2006. The increase in acquisition expenses was primarily due to a change in the mix of business as well as an adjustment related to the earning of acquisition expenses within the U.S. individual risk portfolio recorded in the first quarter of 2007. The operating expense ratio increase was due primarily to higher compensation expenses and corporate allocations, combined with a lower level of net premiums earned.

Foreign exchange gains in the years ended December 31, 2008, 2007 and 2006 were due primarily to the change in the value of the U.S. dollar against certain European currencies including the U.K. Sterling and the Euro on certain inter-company balances and net underwriting liability balances.

Net results from structured reinsurance products include certain structured indemnity contracts that are accounted for as deposit contracts. Results from these products for the twelve months ended December 31, 2008, increased slightly compared to the same period in 2007 mainly due to lower interest expenses associated with a higher accretion rate recorded in 2007 on certain workers compensation coverage and were partially offset by lower net investment income. Net investment income decreased mainly as a result of lower yields earned on invested assets in 2008 as compared to 2007 combined with the impact of a lower average investment asset base. Results from these products for the year ended December 31, 2007 decreased compared to the same period in 2006 mainly as a result of a higher accretion rate recorded in

2007 on deposit liabilities relating to certain workers compensation coverage and partially offset by higher net investment income in 2007 as a result of an increase in the average size of investment asset balances as a result of new transactions.

Life Operations

In 2008, the Company announced its intention to review strategic opportunities relating to its Life reinsurance business which resulted in the Company selling the renewal rights to its life, accident and health business, a relatively small block of business, in late 2008. The Company continues to explore various strategic options for its annuity book, the mortality and critical illness book and as well for its U.S. life business.

The following table summarizes the contribution from this segment:

(U.S. dollars in thousands)	**2008**	**% Change 08 vs 07**	**2007**	**% Change 07 vs 06**	**2006**
Gross premiums written	$ 690,915	(7.0)%	$ 743,220	8.2 %	$ 686,906
Net premiums written	649,844	(7.0)%	698,693	8.1 %	646,608
Net premiums earned	649,851	(7.3)%	701,047	8.4 %	646,450
Fee income and other	350	(49.9)%	698	113.5 %	327
Claims and policy benefits	769,004	(13.5)%	888,658	10.1 %	807,255
Acquisition costs	96,280	5.9 %	90,923	21.8 %	74,675
Operating expenses	33,178	(4.8)%	34,838	(2.5)%	35,720
Exchange losses (gains)	14,514	NM *	(1,121)	NM *	(8,158)
Net investment income	382,995	(1.9)%	390,227	10.9 %	351,935
Contribution from Life Operations	$ 120,220	52.8 %	$ 78,674	(11.8)%	$ 89,220

* NM Not meaningful

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

2008	**2007**

(U.S. dollars in thousands)	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**	**Gross Premiums Written**	**Net Premiums Written**	**Net Premiums Earned**
Other Life	$ 498,387	$ 492,346	$ 492,353	$ 435,415	$ 427,337	$ 429,690
Annuity	192,528	157,498	157,498	307,805	271,356	271,357
Total	$ 690,915	$ 649,844	$ 649,851	$ 743,220	$ 698,693	$ 701,047

While in 2008, the Company s Life Operations did not assume any new long duration single premium annuity portfolios, gross and net premiums written, net premiums earned and claims and policy benefits in each of the two years ended December 31, 2007 and 2006 included the assumption of the following long duration single premium annuity portfolios:

1. Second quarter of 2007 one Irish immediate annuity portfolio bound, for which net premium earned totaled $94.6 million.

2. Second and fourth quarters of 2006 two Irish immediate annuity portfolios bound, for which net premium earned totaled $152.5 million.

The Company acquired cash and investment assets related to the future policy benefit reserves assumed at inception of these large contracts. While the Company may write more of these contracts, the frequency of these transactions will likely continue to be irregular and their sizes will differ from transaction to transaction.

Gross premiums written relating to other life business increased by $63.0 million in the twelve months ended December 31, 2008 as compared to the same period in 2007 mainly due to premium growth in the core underlying book of term assurance and critical illness business of $47.0 million, premium growth in U.S. business of $25.0 million and partially offset by unfavorable foreign exchange rate movements of $16.0 million. In addition, gross premiums written related to short-term life, accident and health business increased by $7.0 million primarily as a result of favorable foreign exchange rate movements and partially by decreases in gross premiums written associated with soft market conditions experienced in 2008. Gross premiums written relating to annuity business decreased by $115.3 million during the year ended December 31, 2008 as compared to the same period in 2007 mainly due to a single Irish immediate annuity contract totaling $94.6 million written during 2007, unfavorable foreign exchange rate movements of $19.3 million and $1.4 million lower premiums from other annuity business which decreases through time as defined by the treaties. Ceded premiums written were roughly consistent with the prior year.

Gross premiums written relating to other life business increased by $98.9 million or 29.4% in the year ended December 31, 2007 as compared to the year ended December 31, 2006 primarily as a result of growth in the underlying book of term assurance and critical illness business of $79.6 million, combined with favorable foreign exchange movements of $19.3 million. Gross premiums written relating to annuity business decreased by $42.6 million or 12.2% in the year ended December 31, 2007 as compared to the year ended 2006 mainly due to a lower level of single premium annuity portfolio business of $57.8 million, offset by favorable foreign exchange rate movements of $15.2 million. Ceded premium ratios remained roughly consistent with the prior year.

Net premiums earned in the year ended December 31, 2008 decreased by 7.3% as compared to the same period in 2007. Net premiums earned in the year ended December 31, 2007 increased 8.4% as compared to the same period in 2006. The decrease in 2008 and the increase in 2007 were consistent with the movements in total gross and net premiums written as described above.

Changes in claims and policy benefit reserves were generally consistent with movements in gross and net premiums written but also included the movement in policy benefit reserves related to other contracts (such as tranches of immediate annuity portfolios) where investment assets were acquired with the assumption of the policy benefit reserves at the inception of the contract. Claims and policy benefit reserves decreased by $119.7 million or 13.5% in the year ended December 31, 2008 as compared to the same period in 2007, primarily as a result of the factors noted above affecting gross and net premiums written, combined with a loss recognition adjustment of $25.4 million recorded in 2007 relating to certain novated blocks of U.S.-based term life mortality reinsurance business and partially offset by higher incurred losses of $11.5 million associated with certain short-term life, accident and health business. Claims and policy benefit reserves increased by $81.4 million or 10.1% in the year ended December 31, 2007 as compared to the same period in 2006 mainly as a result of growth in the underlying block of term assurance and critical illness business increasing losses by $65.2 million, unfavorable foreign exchange rate movements of $52.8 million, a loss recognition adjustment of $25.4 million relating to certain novated blocks of U.S.-based term life mortality reinsurance business, offset by lower losses relating to single premium immediate annuity business of $62.0 million from fewer single premium portfolio contracts bound during the year.

For the twelve months ended December 31, 2008, acquisition costs increased by 5.9% as compared to the same period in 2007, largely as a result of the growth in regular premium business as noted above and partially offset by a favorable profit commission adjustment associated with the short-term life, accident and health business and favorable foreign exchange rate impacts. Operating expenses decreased by 4.8% in the twelve months ended December 31, 2008 as compared to the same period in the prior year mainly due to lower performance-based compensation expenses and a decrease in professional fees as a result of costs recorded in 2007 related to an actuarial loss reserve review.

Acquisition costs increased by 21.8% in 2007 as compared to 2006 mainly as a result of the growth in the book of regular term assurance and critical illness treaties consistent with the earned premium variance, as well as the impact of a favorable profit commission adjustment recorded in 2006 relating to a term life treaty. Operating expenses decreased by 2.5% in 2007 as compared to 2006 primarily as a result of a decrease in both professional fees and corporate allocations, offset by unfavorable foreign exchange rate movements and higher compensation costs.

Net investment income is included in the calculation of contribution from Life Operations, as it relates to income earned on portfolios of separately identified and managed life investment assets and other allocated assets. Net investment income decreased by $7.2 million or 1.9% in the year ended December 31, 2008, as compared to the same period in 2007 primarily as a result of negative foreign exchange rate impacts and partially offset by higher net investment income associated with growth in the average size of the investment asset balances due to premiums associated with regular premium business. However, it should be noted that as at December 31, 2008, approximately $1.1 billion of the gross unrealized losses on the Company s investments related to portfolios of Life Operations investment assets primarily as a result of increases in credit spreads during this period, primarily in the U.K. and Euro-zone, and the long duration of the underlying assets. Refer to Balance Sheet Analysis below for further discussion of unrealized losses and gains on investments.

Net investment income increased by $38.3 million or 10.9% in 2007 as compared to 2006, primarily as a result of favorable foreign exchange rate movements of $23.9 million and increases in the average size of investment asset balances.

Other Financial Lines

The Other Financial Lines segment is comprised of the funding agreement business and previously, the GIC business. As at December 31, 2007, the Company had approximately $4.0 billion of deposit liabilities associated with GICs which were correspondingly matched with invested assets. Based on the terms and conditions of the underlying GICs, upon the downgrade of Syncora Guarantee (formerly XL Capital Assurance Inc. or XLCA), below certain ratings levels, all or portions of outstanding principal balances on such GICs would come due. Throughout 2008, several rating agencies downgraded Syncora and its subsidiaries and, as a result, the Company settled during 2008 all of the GIC liabilities. At December 31, 2008, the remaining balance of funding agreements, excluding accrued interest of $6.6 million, was $600.0 million, with settlements scheduled through to 2010. Management does not expect any significant impact on the Company s results of operations or liquidity as a result of the maturity of these contracts.

At December 31, 2007, a significant component of the investments held in the Company s Other Financial Lines segment portfolios was comprised of Topical Assets and CDOs. Liquidations necessary to fund the repayment of the GIC liabilities following the downgrade of Syncora Guarantee and the maturity of certain funding agreements, were funded through sales of assets in these portfolios as well as the general investment portfolios. Management s approach was to avoid the sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold a number of the Topical Assets and CDOs and these were transferred to the general investment portfolio in exchange for those assets that were liquidated.

For the year ended December 31, 2008, the net results from these structured products were $18.1 million and included net investment income, interest expense and operating expenses of $100.4 million, $72.6 million, and $9.7 million, respectively, while for the year ended December 31, 2007, the net results from these structured products were $48.1 million and included net investment income, interest expense and operating expenses of $389.0 million, $326.4 million, and $14.5 million, respectively. For the year ended December 31, 2006, the net results from these structured products were $34.7 million and included net investment income, interest expense and operating expenses of $341.9 million, $296.9 million, and $10.4 million, respectively. For the year ended December 31, 2008, net investment income, interest expense and operating expenses decreased primarily as a result of a decrease in the average deposit liability balance and the associated asset portfolios as a result of the settlement of the GIC portfolio and certain funding agreements noted above. In addition, operating expenses decreased due to a reduction in compensation expense associated with a lower headcount. While not reported within the contribution from the Other Financial Lines segment, approximately $97.1 million of the reported realized losses on investments during 2008 related to portfolios associated with GICs and funding agreements.

For 2007, net investment income increased primarily as a result of an increase in yields on invested assets. Interest expense increased due to an increase in the average deposit liability balance combined with an increase in crediting rates consistent with the yield changes noted above. Operating expenses increased by $4.1 million during 2007 as compared to 2006 primarily due to reclassification of certain contract expenses and partially offset by reduced corporate allocations.

Syncora

For further information on Syncora, see Results of Operations and Other Revenues and Expenses within Management s Discussion and Analysis of Financial Condition and Results of Operations. In addition, see Notes 4 and 10 to the Consolidated Financial Statements, Syncora Holdings Ltd. and Investments in Affiliates , for further information.

Investment Activities

The following table illustrates the change in net investment income from property and casualty operations, net income from investment fund affiliates, net realized (losses) gains on investments, and net realized and unrealized (losses) gains on investment derivative instruments for each of the three years ended December 31:

(U.S. dollars in thousands)	**2008**	**% Change 08 vs 07**	**2007**	**% Change 07 vs 06**	**2006**
Net investment income property and casualty operations (1)	$ 1,174,856	(8.9)%	$ 1,289,554	18.2 %	$ 1,090,785
Net (loss) income from investment fund affiliates (2)	(277,696)	NM *	326,007	21.2 %	269,036
Net realized (losses) on investments	(962,054)	(59.5)%	(603,268)	NM *	(116,458)
Net realized and unrealized (losses) gains on investment and other derivative instruments (3)	(73,368)	(32.3)%	(55,451)	NM *	101,183

(1) Net investment income relating to property and casualty operations does not include the net investment income related to the

net results from structured products.

(2) The Company records the income related to alternative fund affiliates on a one month lag and the private investment fund affiliates on a three month lag in order for the Company to meet the accelerated filing deadlines.

(3) For a summary of realized and unrealized gains and losses on all derivative instruments, see Item 8, Note 17 to the Consolidated Financial Statements, Derivative Instruments.

* NM Not meaningful

Net investment income related to property and casualty operations decreased in the year ended December 31, 2008 as compared to the same period in 2007 due primarily to declining portfolio yields. Portfolio yields decreased as yields earned on investment of cash flows and reinvestment of maturing or sold securities were generally lower than on securities previously held, as prevailing market interest rates, particularly in the U.S., decreased over the last year. As well, the portfolio mix changed as a result of the settlement of the GIC and funding agreements liabilities, as the property and casualty operations assumed a number of the floating rate securities previously held in the Company s Other Financial Lines segment and as a result is more sensitive to changes in short-term U.S. interest rates as well as increased allocations to lower yielding government, agency and cash securities.

Net investment income related to property and casualty operations increased in 2007 as compared to 2006 due primarily to a higher investment base and increases in the yield of the portfolio. The increase was primarily due to the full 2007 financial year impact of the higher interest rates experienced in the U.S., U.K. and Euro-zone, during the latter part of 2006 and the beginning part of 2007.

Net income from investment fund affiliates includes earnings from the Company s investments in closed-end investment funds and partnerships and similar vehicles that are equity accounted. The Company s net loss from investment fund affiliates during the year ended December 31, 2008 reflected negative returns in the Company s alternative portfolio. Broad-based market declines, combined with extreme volatility, a sharp pull-back in the availability of credit and short sale restrictions implemented by securities market regulators proved highly challenging for the strategies employed by many of the Company s alternative investment managers as the markets during 2008 were particularly challenging for strategies employed by the Company s alternative investment managers given the extreme volatility, overall pull back of credit availability, Net income from investment fund affiliates increased in 2007 as compared to 2006 due primarily to exceptional results in the alternative portfolio and as a result of a higher investment asset base

Investment Performance

The Company manages its investment grade fixed income securities using an asset/liability management framework. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful.

Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the investment portfolio returns for the years ended December 31, 2008 and 2007 of the asset/liability portfolio and risk asset portfolios:

	2008(1)	2007(1)
Asset/Liability Portfolio		
USD fixed income portfolio	(9.2)%	1.6%
Non-USD fixed income portfolio	(2.0)%	1.0%
Risk Asset Portfolio		
Alternative portfolio (2).	(16.3)%	17.0%
Equity portfolio	(44.1)%	10.1%
High-Yield fixed income portfolio	(22.9)%	0.9%

(1) Portfolio returns are calculated by dividing the sum of the net investment income or net income from investment fund affiliates, realized gains (losses) and unrealized gains (losses) by the average market value of each portfolio. Performance is measured in either the underlying asset currency or the functional

currency.

(2) Performance on the alternative portfolio reflects the twelve months ended November 30, 2008 and 2007, respectively.

Net Realized Gains and Losses on Investments and Other than Temporary Declines in the Value of Investments

The Company s investment portfolio is classified as available for sale. Realized investment gains and losses occur through the normal turnover of the Company s investment portfolio. Realized investment losses include impairment charges relating to declines in value of securities that are considered to be other than temporary. See Critical Accounting Policies and Estimates for further information.

Net realized losses on investments in the twelve months ended December 31, 2008 included net realized losses of approximately $1,023.6 million related to the write-down of certain of the Company s fixed income, equity and other investments, including those relating to Lehman, where the Company determined that there was an other than temporary decline in the value of those investments, including a charge of $400.0 million related to assets for which the Company could no longer assert its intent to hold until recovery. See below for further information. Included in net realized losses noted above are net realized gains of $98.8 million related to the foreign exchange component of inter-company sales of assets. Further details are included in Results of Operations.

During the fourth quarter of 2008, management recorded a charge for OTTI of $400.0 million on assets for which it could no longer assert its intent to hold until recovery. Management believes that these securities were at-risk for further mark-to-market declines, and potentially real economic losses, to the extent that economic conditions were to deteriorate further than present estimates and the Company s allocation to these asset classes is overweight relative to a traditional P&C portfolio. Accordingly, in conjunction with its risk reduction exercise, management is likely to pursue targeted sales of these assets over the course of 2009, and expects to realize the associated losses on these securities. The assets are concentrated in certain holdings within the Company s BBB and lower corporate, CMBS, equity and consumer ABS portfolios.

In 2007, net realized losses on investments were $603.3 million which included $1,012.8 million of gross realized losses on fixed income and $46.9 million of gross realized losses on equity securities. Gross realized losses in 2007 included $611.0 million of provisions for declines in fair value considered to be other than temporary. As a percentage of the total fixed income portfolio, the write-down for other than temporary declines was 1.5% in 2007 as compared to 0.3% in 2006.

In 2006, net realized losses on investments were $116.5 million which includes $390.4 million of gross realized losses on fixed income and $88.5 million of gross realized losses on equity securities. Gross realized losses in 2006 included $151.4 million of provisions for declines in fair value considered to be other than temporary.

With respect to those securities that were sold at a loss during the year ended December 31, 2008, the following is an analysis of the period of time that those securities had been in a continual unrealized loss position, the amount of the realized loss recorded in the Company s results of operations as of the sale date and the amount of the impairment charge taken in the year:

Length of time in a continual unrealized loss position *(U.S. dollars in thousands)*	**Fixed Income Securities**	**Equity Securities**
Less than 6 months	$ 178,194	$ 74,619
At least 6 months but less than 12 months	44,626	30,547
At least 12 months but less than 2 years	53,852	9,549
At least 2 years	68,367	404
Total gross realized loss from sales	345,039	115,119
Impairment charges for declines in value considered to be other than temporary	912,228	109,928
Total gross realized loss	$ 1,257,267	$ 225,047

With respect to those securities that were sold at a loss during the year ended December 31, 2007, the following is an analysis of the period of time that those securities had been in a continual unrealized loss position, the amount of the realized loss recorded in the Company s results of operations as of the sale date and the amount of the impairment charge taken in the year:

Length of time in a continual unrealized loss position *(U.S. dollars in thousands)*	**Fixed Income Securities**	**Equity Securities**
Less than 6 months	$ 111,174	$ 32,023
At least 6 months but less than 12 months.	202,682	8,294
At least 12 months but less than 2 years	42,234	3,887
At least 2 years	48,393	126
Total gross realized loss from sales	404,483	44,330
Impairment charges for declines in value considered to be other than temporary	608,322	2,600
Total gross realized loss	$ 1,012,805	$ 46,930

The Company s process for identifying declines in the fair value of investments that are other than temporary involves consideration of several factors, as discussed under Critical Accounting Policies and Estimates.

During the year ended December 31, 2008, the Company realized losses of $122.2 million and $10.0 million upon the sale of fixed income securities and equity securities, respectively, that had been in an unrealized loss position for greater than twelve months. During the year ended December 31, 2007, the Company realized losses of $90.6 million and $4.0 million upon the sale of fixed income securities and equity securities, respectively, that had been in an unrealized loss position for greater than twelve months. The decisions to sell these securities were made by the Company s investment managers based upon a change in market conditions and other factors (these decisions were independent of the Company s previously stated intent and ability to hold such securities).

Net Realized and Unrealized Gains and Losses on Derivatives

Net realized and unrealized losses on investment derivatives for the year ended December 31, 2008 resulted from the Company s investment strategy to manage interest rate risk, foreign exchange risk and credit risk, and to replicate permitted investments. Included in these amounts are gains associated with purchased credit default swaps offset by losses related to interest rate swap positions. Net realized and unrealized losses on investment and other derivatives for the same period in 2007 resulted primarily from a mark-to-market loss of $37.0 million with respect to a total return swap on the capital notes of a structured investment vehicle impacted by the markdown in the underlying net asset value of the assets of the capital notes, combined with mark-to-market losses associated with the Company s capital, investment and hedging activities.

For a further discussion see Item 7A, Quantitative and Qualitative Disclosures About Market Risk and Liquidity and Capital Resources.

Other Revenues and Expenses

The following table sets forth other revenues and expenses of the Company for each of the three years ended December 31:

(U.S. dollars in thousands)	2008	% Change 2008 vs 2007	2007	% Change 2007 vs 2006	2006
Net (loss) income from operating affiliates (1)	$ (1,458,246)	(37.6)%	$ (1,059,848)	NM *	$ 111,670
Impairment of goodwill	989,971	NM *		NM *	
Amortization of intangible assets	2,968	76.7 %	1,680	(28.7)%	2,355
Corporate operating expenses	168,324	20.7 %	139,469	(30.2)%	199,723
Interest expense (2)	206,455	(1.9)%	210,449	1.7 %	207,066
Extinguishment of debt	22,527	NM *		NM *	
Income tax expense	222,578	(4.8)%	233,922	6.5 %	219,645
Minority interest		(100.0)%	23,928	(4.3)%	25,016

(1) The Company records the income related to certain operating affiliates on a three month lag in order for the Company to meet accelerated filing deadlines.

(2) Interest expense does not include interest expense related structured products as reported within the Insurance and Reinsurance segments.

* NM Not meaningful

The following table sets forth the net income (loss) from operating affiliates for each of the three years ended December 31:

(U.S. dollars in thousands)		**2008**	**% Change 2008 vs 2007**		**2007**	**% Change 2007 vs 2006**		**2006**
Net (loss) income from financial operating affiliates	$	(1,503,474)	(26.3)%	$	(1,190,161)	NM *	$	23,461
Net income from investment manager affiliates		10,860	(88.5)%		94,630	21.8 %		77,690
Net income from other strategic operating affiliates		34,368	(3.7)%		35,683	239.2 %		10,519
Total	$	(1,458,246)	(37.6)%	$	(1,059,848)	NM *	$	111,670

The net loss from financial operating affiliates for the year ended December 31, 2008 was primarily a result of the loss of approximately $1.4 billion recorded in August 2008 in relation to the closing of the Master Agreement as well as losses recorded throughout 2008 and up until the closing of the Master Agreement that were associated with previous reinsurance and guarantee agreements with Syncora. Net losses from financial operating affiliates in 2007 include the results and related write-downs associated with Syncora and Primus as well as the impact of losses recorded on previous reinsurance transactions with Syncora of approximately $351.0 million. For further details relating to

Syncora and the closing of the Master Agreement, see Results of Operations above as well as Note 4 to the Consolidated Financial Statements, Syncora Holdings Ltd. (Syncora).

Investment manager affiliate income decreased by $83.8 million or 88.5% during the twelve months ended December 31, 2008 as compared to the same period in the prior year primarily as a result of recent volatility in both the credit and equity markets, impacting investment manager affiliates specializing in global equities and fixed income securities most significantly. Investment manager affiliate income increased in 2007 as compared to 2006 mainly due to strong results generated from certain global equity and mortgage specialist investment manager affiliates, partially offset by the write-off of the Company s investment in a manager that managed a series of structured investment vehicles and conduits.

Net income from other strategic operating affiliates decreased in the twelve months ended December 31, 2008 as compared to the same period in 2007 mainly due to lower earnings reported in 2008 from both an insurance affiliate which writes largely direct U.S. homeowners insurance and the Company s Brazilian joint venture ITAÚ XL. Offsetting these decreases was earnings from an investment in an affiliate entered into in the second quarter of 2008 that provides reinsurance to certain Lloyd s syndicates. Net income from other strategic operating affiliates increased in 2007 as compared to 2006, primarily as a result of strong results from the same insurance affiliate noted above which writes largely U.S. homeowners insurance and the Company s Brazilian joint venture ITAÚ XL.

Due to the financial market and economic events that occurred in the fourth quarter of fiscal 2008, the Company performed an interim impairment test for goodwill subsequent to its annual testing date of June 30. The interim impairment test resulted in a non-cash goodwill impairment charge of approximately $990.0 million. For further information, see Item 8, Note 7 to the Consolidated Financial Statements, Goodwill and Other Intangible Assets and see further discussion under Critical Accounting Policies and Estimates.

Amortization of intangible assets increased in 2008 as a result of the increase in intangible assets related to the XL GAPS acquisition in 2007. Amortization of intangible assets decreased in 2007 as a result of certain intangible assets that were fully amortized during 2006.

Corporate operating expenses in the twelve months ended December 31, 2008 increased compared to the same period in 2007 primarily as a result of increases in professional fees associated with the execution of the Master Agreement described above as well as costs recorded in 2008 relating to the Company s expense reduction initiative, including employee termination benefits as well as costs associated with ceasing to use certain leased property accounted for as operating leases. For further information, see Note 5 to the Consolidated Financial Statements, Restructuring and Asset Impairment Charges. Offsetting these increases were lower compensation expenses as a result of performance based accruals recorded in 2007. Corporate operating expenses decreased by 30.2% in 2007 as compared to 2006 primarily as a result of certain compensation costs being allocated to the operating segments in 2007.

Interest expense from property and casualty operations includes costs related to the Company s debt and collateral facilities as well as certain deposit liability accretion. Interest expense for the year ended December 31, 2008 as compared to the same period in 2007 was lower primarily due to costs associated with the retirement of the 2009 Senior Notes recorded in 2007, lower interest expense as a result of the early redemption, in August 2008, of X.L. America, Inc. s 6.58% Notes and was partially offset by interest expense associated with the 10.75% Equity Security Units (the 10.75% Units) issued in August 2008. Interest expense was higher in 2007 as compared to 2006 primarily due to the issuance of the 2027 Senior Notes in early May 2007 as well as the costs associated with the retirement of the 2009 Senior Notes. For more information on the Company s financial structure, see Liquidity and Capital Resources.

In connection with the early redemption of the 6.58% Notes as noted above, the Company recorded debt extinguishment costs of approximately $22.5 million in 2008.

The decrease in the Company s income taxes in 2008 as compared to 2007 was primarily a result of a change in the geographical locations of the profits earned primarily by the Company s U.S. and European operations, including the impact of losses associated with the Master Agreement and goodwill impairment charges related to operating entities in jurisdictions not subject to income tax. The Company s effective tax rate for the year ended December 31, 2008 differed as compared to the same period in 2007 mainly due to significant charges for which no tax benefit accrued and which resulted in a loss before tax. Income tax expense for the year ended December 31, 2007 increased as compared to the same period in 2006, principally from an improvement in the profitability of the Company s U.S. and European property and casualty operations in those respective years. The Company s effective tax rate for the year ended December 31, 2007 increased from that in 2006 due primarily to non-deductible asset impairment charges recorded in Bermuda, the U.S. and the U.K.

The deferral of tax losses is evaluated based upon the future profitability of the Company s taxable entities and, under current projections, the Company anticipates using this asset. The Company s net deferred tax asset at December 31, 2008 was $331.3 million, which consisted primarily of net operating losses generated by subsidiaries in the U.K. Should the taxable income of these entities fall below expectations, a further valuation allowance may have to be established, which could be significant. In addition, if any further losses are generated by these entities, these losses may not be tax effected. See Critical Accounting Policies and Estimates and Item 8, Note 24 to the Consolidated Financial Statements, Taxation.

Minority interest expense in 2007 related primarily to the 37% ownership interest in Syncora common shares held by the public prior to the secondary offering of Syncora common shares on June 6, 2007, while minority interest expense in 2006 related primarily to the 37% ownership interest in Syncora following the initial public offering in August 2006 as well as the minority interest ownership in preferred shares of Syncora Guarantee Re.

Balance Sheet Analysis

Investments

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and to build book value for the Company over the longer term. The strategy strives to balance investment returns against market and credit risks taken. The Company s overall investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance.

At December 31, 2008 and 2007, total investments, cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased) were $34.3 billion and $43.7 billion, respectively. The following table summarizes the composition of the Company s invested assets at December 31, 2008 and 2007:

(U.S. dollars in thousands)		**Fair Value 2008**	**Percent of Total**		**Fair Value 2007**	**Percent of Total**
Cash and cash equivalents	$	4,353,826	12.7 %	$	3,880,030	8.9 %
Net receivable (payable) for investments sold (purchased)		99,455	0.3 %		(191,472)	(0.4)%
Accrued investment income		363,376	1.1 %		447,660	1.0 %
Short-term investments		1,466,323	4.3 %		1,803,198	4.1 %
Fixed maturities:						
U.S. Government and Government agency	$	3,978,342	11.6 %	$	2,685,773	6.1 %
Corporate		9,288,603	27.1 %		12,987,248	29.7 %
Mortgage and asset-backed securities		8,526,256	24.9 %		14,493,877	33.1 %
U.S. States and political subdivisions of the States		468,770	1.4 %		253,534	0.6 %
Non-U.S. Sovereign Government		3,374,397	9.8 %		3,187,358	7.3 %
Total fixed maturities	$	25,636,368	74.8 %	$	33,607,790	76.8 %
Equity securities		361,819	1.0 %		854,815	2.0 %
Investments in affiliates		1,552,789	4.5 %		2,611,149	6.0 %
Other investments		459,481	1.3 %		708,476	1.6 %
Total investments and cash and cash equivalents	**$**	**34,293,437**	**100.0 %**	**$**	**43,721,646**	**100.0 %**

The Company reviews on a regular basis its issuer concentration, credit quality and compliance with established guidelines. At December 31, 2008 and 2007, the average credit quality of the Company s total fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) was AA. At December 31, 2008 approximately 53.9% of the fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net receivable (payable) for investments sold (purchased)) was rated AAA by one or more of the principal ratings agencies. Approximately 2.5% of the fixed income portfolio was below investment grade or not rated.

At December 31, 2008 and 2007, total investments, cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased) were $34.3 billion and $43.7 billion, respectively. This decrease of $9.4 billion was primarily due to the settlement of the Company s GIC liabilities in 2008, the mark-to-market effect as a result of the challenging credit markets, depreciation of the Sterling assets as measured in U.S. dollars, the payment of $1.8 billion to Syncora under the Master Agreement and was partially offset by cash flow from the Company s financing activities in August 2008. The annualized effective yield of the total investment portfolio (excluding non-recurring items) was 4.8% for 2008 as compared to 5.2% for 2007, a 0.4% decrease. The decrease in the effective yield of the total investment portfolio was primarily due to declines in U.S. interest rates and the resulting impact on the Company s floating rate assets, as well as increased allocations to lower yielding government, agency and cash securities.

Refer to Results of Operations for further discussion surrounding the impact of credit market movements on the Company s investment portfolio and exposure to sub-prime related assets.

Net Unrealized Gains and Losses on Investments

At December 31, 2008, the Company had net unrealized losses on fixed maturities and short-term investments of $3,388.6 million and net unrealized gains on equity securities of $24.1 million. Of these amounts, gross unrealized losses on fixed maturities and short-term investments and equities were $4,122.3 million and $7.6 million, respectively. At December 31, 2007, the Company had net (pre-tax) unrealized losses on fixed maturities and short-term investments of $637.3 million and net unrealized gains on equity securities of $190.6 million. Of these amounts, gross unrealized losses on fixed maturities and short-term investments and equities were $1,069.5 million and $14.9 million, respectively. The impact of the deteriorating corporate and structured credit spreads during the twelve months ended December 31, 2008, was the primary reason for the decline in the net unrealized position on fixed maturities and short-term investments, offset by the impact of declining government rates in the U.S.and the U.K. The information shown below about the unrealized losses on the Company s investments at December 31, 2008 and 2007 concerns the potential effect upon future earnings and financial position should management later conclude that some of the current declines in the fair value of these investments are other than temporary.

The following is an analysis of how long each of those investment securities with an unrealized loss at December 31, 2008 and 2007 had been in a continual unrealized loss position:

Type of Securities *(U.S. dollars in thousands)*	**Length of time in a continual unrealized loss position**	**Amount of unrealized loss at December 31, 2008**	**Amount of unrealized loss at December 31, 2007**
Fixed-Maturities and Short-Term Investments	Less than six months	$ 798,866	$ 145,992
	At least 6 months but less than 12 months	664,593	575,913
	At least 12 months but less than 2 years	1,955,760	309,148
	2 years or more	703,104	38,446
	Total	$ 4,122,323	$ 1,069,499
Equities	Less than six months	$ 5,584	$ 10,400
	At least 6 months but less than 12 months	1,994	4,496
	Total	$ 7,578	$ 14,896

At December 31, 2008 and 2007, the following table sets forth the maturity profile of the fixed income securities that were in a gross unrealized loss position:

Maturity profile in years of fixed maturity securities in a gross unrealized loss position *(U.S. dollars in thousands)*	**Amount of unrealized loss at December 31, 2008**	**Amount of unrealized loss at December 31, 2007**
Less than 1 year remaining	$ 38,702	$ 23,695
At least 1 year but less than 5 years remaining	622,011	103,081
At least 5 years but less than 10 years remaining	438,837	150,786
More than 10 years but less than 20 years remaining	205,371	60,471
At least 20 years or more remaining	843,274	233,689
Mortgage and asset-backed securities	1,974,128	497,777
Total	$ 4,122,323	$ 1,069,499

At December 31, 2008, the total gross unrealized losses represented approximately 7,800 fixed income securities out of a total of approximately 14,100 fixed income securities (representing fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) and approximately 30 equity securities out of a total of approximately 1,475. At December 31, 2007, the total gross unrealized losses represented approximately 7,600 fixed income securities out of a total of approximately 17,100 fixed income securities (representing fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) and approximately 300 equity securities out of a total of approximately 1,000.

Of the gross unrealized investment losses on the fixed income and short term investments portfolio at December 31, 2008 of $4.1 billion, approximately $2.0 billion related to corporate fixed income securities. Within the corporate fixed income securities, approximately 48.5% of the losses were in the financial sector and 20.1% in the diversified sector. No other sector was greater than 5%. The largest unrealized loss in the fixed income portfolio was $29.4 million.

No equity securities held by the Company at December 31, 2008 were in a continual unrealized loss position for 12 months or longer. The largest individual unrealized loss in the equity portfolio was $6.8 million.

Of the gross unrealized investment losses on the fixed income and short term investments portfolio at December 31, 2007 of $1.1 billion, approximately $546.1 million related to corporate fixed income securities. Within the corporate fixed income securities, approximately 68.0% of the losses were in the financial sector and 12.3% in the diversified sector. No other sector was greater than 5%. The largest unrealized loss in the fixed income portfolio was $7.9 million.

No equity securities held by the Company at December 31, 2007 were in a continual unrealized loss position for 12 months. The largest individual unrealized loss in the equity portfolio was $1.0 million.

Factors considered in determining that additional OTTI charges were not warranted include management s consideration of current and near term liquidity needs and other available sources, an evaluation of the factors and time necessary for recovery, and the results of on-going retrospective reviews of security sales and the basis for such sales.

Gross unrealized losses of $4.1 billion at December 31, 2008 can be attributed to the following significant drivers:

gross unrealized losses of $1.0 billion related to the Company s Life Operations investment portfolio, which had a fair value of $5.6 billion as at December 31, 2008. Of this, $673.4 million of gross unrealized losses related to $1.7 billion of exposures to corporate financial institutions including Tier One and Upper Tier Two securities. At December 31, 2008, this portfolio had average interest rate duration of 8.9 years, primarily denominated in U.K. Sterling and Euros. As a result of the long duration, significant gross losses have arisen as the fair values of these securities are more sensitive to prevailing government interest rates and credit spreads. This portfolio has limited turnover as it is matched to corresponding long duration liabilities. A hypothetical parallel increase in interest rates and credit spreads of 50 and 25 basis points, respectively, would increase the unrealized losses related to this portfolio at

December 31, 2008 by approximately $236.9 million and $82.2 million, respectively. Given the long term nature of this portfolio, and the level of credit spreads as at December 31, 2008 relative to historical averages within the U.K. and Euro-zone as well as the Company s liquidity needs at December 31, 2008, the Company believes that these assets will continue to be held until such time as they mature, or credit spreads revert to levels more consistent with historical averages. The Company continues to explore strategic alternatives with respect to its Life Operations segment. The conclusion of such consideration could impact the amount and timing of any impairment related to this portfolio.

gross unrealized losses of $1.1 billion related to the corporate holdings within the Company s non-life fixed maturity portfolios, which had a fair value of $6.9 billion as at December 31, 2008. The Company believes these impairments are a function of the currently elevated levels of corporate credit spreads in the U.S. and globally, which spiked particularly during the third and fourth quarters of 2008, resulting in a severely depressed level of valuations. The amount of these gross losses has proven very volatile as a result of the severe deterioration in credit spreads in recent months. For example, the gross unrealized losses increased by approximately $458.3 million or 6.7% of amortized cost during the third and fourth quarters of 2008, a period in which U.S. corporate credit spreads increased by approximately 300 basis points from what were already elevated levels, excluding the impact of foreign currency movements and offset by the impact of interest rate declines. The Company believes that the gross unrealized losses are a reflection of a severe premium being charged by the market for credit, rather than fundamental deterioration in the debt service capabilities of the issuers.

gross unrealized losses of $602.9 million related to the Topical Asset portfolio (which consists of the Company s holdings of sub-prime non-agency securities, second liens, ABS CDOs with sub-prime collateral as well as Alt-A mortgage exposures), which had a fair value of $963.3 million as at December 31, 2008. The Company undertook a security level review of these securities and recognized charges to the extent it believed the intrinsic value of any security was below its amortized cost. The Company has recognized realized losses, consisting of charges for OTTI and realized losses from sales, of approximately $660.8 million since the beginning of 2007 and through

December 31, 2008 on these asset classes.

The Company purchased a number of these assets to support the previously written GIC and funding agreement contracts and has announced its intention to reduce its exposure to this asset class as part of its strategic portfolio realignment. The Company believes that based on market conditions and liquidity needs at December 31, 2008, this reduction will be realized through natural cash flows of the portfolio, and limited selective sales, rather than selling these assets into markets which continue to be illiquid and not reflective of the intrinsic value of these assets. The weighted average term-to-maturity of the sub-prime and Alt-A residential holdings within this portfolio at December 31, 2008 were 3.6 years and 3.5 years, respectively. The Company, based on current market conditions and liquidity needs as well as its assessment of the holdings, believes it will continue to hold these securities until either maturity, or a return of liquidity and valuations more reflective of the intrinsic value of these holdings.

gross unrealized losses of $469.9 million related to the non-life portfolio of Core CDO holdings (defined by the Company as investments in non-mortgage collateralized debt obligations), which consisted primarily of collateralized loan obligations and had a fair value of $665.5 million as of December 31, 2008. The Company undertook a security level review of these securities and recognized charges to the extent it believed the intrinsic value of the security was below the amortized cost. The Company believes that the level of impairment is primarily a function of historically wide spreads in the collateralized loan obligations market during the period, driven by the high level of illiquidity in this market. The Company purchased a number of these assets to support the previously written GIC and Funding Agreement contracts and has announced its intention to reduce its exposure to this asset class over time as a part of its strategic portfolio realignment. The Company, based on current market conditions and liquidity needs as well as its assessment of the holdings, believes it is likely that the Company will continue to hold these securities until either maturity or a recovery of value, following which the Company intends to reduce its exposure to this asset class.

gross unrealized losses of $346.5 million related to the non-life portion of CMBS holdings, which had a fair value of $2.1 billion as at December 31, 2008. The Company s holdings in CMBS are 97.5% rated AAA. The Company s exposure to downgrades has been negligible, and it believes that the currently depressed pricing, which represents approximately 79.8% of the par value of the securities, is directly related to the 753 basis point widening in credit spreads within this market, as a result of the heightened risk premium attached to property collateral. Our portfolio is highly diversified, has limited delinquencies and has experienced limited downgrades.

The following table summarizes the fair value, gross unrealized losses, credit rating and asset class of securities in a gross unrealized loss position within the Company s structured credit and corporate portfolios, which comprised $4.3 billion of the Company s total gross unrealized loss position of $4.1 billion at December 31, 2008:

(U.S. dollars in millions) **Corporates**	**AAA**	**AA**	**A**	**BBB**	**BB & Below**
Financials (1)					
Fair value	$ 435.2	$ 1,014.2	$ 2,079.8	$ 222.1	$ 36.5
Gross unrealized loss	$ (25.4)	$ (149.0)	$ (660.5)	$ (159.8)	$ (44.0)
Non-Financials					
Fair value	$ 184.9	$ 302.4	$ 1,407.9	$ 1,211.2	$ 463.0
Gross unrealized loss	$ (25.5)	$ (35.8)	$ (335.3)	$ (311.4)	$ (230.1)
Total					
Fair value	$ 620.1	$ 1,316.6	$ 3,487.7	$ 1,433.3	$ 499.5
Gross unrealized loss	$ (50.9)	$ (184.8)	$ (995.8)	$ (471.2)	$ (274.1)
% Impaired (of amortized cost)(3)	(7.8)%	(12.5)%	(22.6)%	(25.1)%	(35.9)%

Structured Credit	**AAA**	**AA**	**A**	**BBB**	**BB & Below**	
CMBS						
Fair value	$ 1,426.8	$ 7.9	$ 6.7	$ 9.5	$ 8.8	$
Gross unrealized loss	$ (331.9)	$ (5.1)	$ (4.9)	$ (7.7)	$ (12.4)	$
Prime RMBS						
Fair value	$ 645.9	$ 125.5	$ 56.6	$ 8.0	$ 24.8	$
Gross unrealized loss	$ (222.7)	$ (67.7)	$ (45.7)	$ (5.9)	$ (13.9)	$
Topical Assets						
Fair value	$ 534.0	$ 175.8	$ 87.0	$ 28.4	$ 53.5	$
Gross unrealized loss	$ (312.6)	$ (157.5)	$ (63.7)	$ (29.9)	$ (39.3)	$
Core CDO s (2)						

Fair value	$	166.7	$	324.6	$	51.7	$	109.2	$	10.2	$
Gross unrealized loss	$	(61.7)	$	(173.9)	$	(46.6)	$	(163.7)	$	(24.4)	$
Other Asset & Mortgage Backed Securities											
Fair value	$	790.0	$	97.9	$	220.8	$	60.4	$	27.8	$
Gross unrealized loss	$	(58.2)	$	(18.4)	$	(74.1)	$	(28.9)	$	(2.3)	$
Total											
Fair Value	$	3,563.4	$	731.7	$	422.8	$	215.5	$	125.1	$
Gross unrealized loss	$	(987.1)	$	(422.6)	$	(235.0)	$	(236.1)	$	(92.3)	$
% Impaired (of amortized cost)(3)		(21.8)%		(36.8)%		(35.9)%		(52.7)%		(42.8)%	

(1) Included in the gross unrealized losses on corporate financials are gross unrealized losses of $637.1 million on Tier One and Tier Two securities of financials institutions (Hybrids), as well as $159.2 million of subordinated debt.

(2) The Company

defines Core CDOs as investments in non-mortgage collateralized debt obligations, primarily consisting of collateralized loan obligations.

(3) Management considers these impairments to be temporary.

Management, in its assessment of whether securities in a gross unrealized loss position are temporarily impaired, considers the significance of the impairments. The Company had securities with gross unrealized losses of $1,174.6 million, with a fair value of $724.8 million, which as at December 31, 2008 were impaired by greater than 50% of amortized costs. The Company has evaluated each of these securities and believes it is probable that the issuer will be able to satisfy all principal and interest payments, and believes that the current levels of impairments are a function of the currently extremely elevated levels of credit spreads.

Structured credit securities with gross unrealized losses representing greater than 50% of amortized cost represent $680.1 million of gross unrealized losses, with a fair value of $384.1 million. Of these gross unrealized losses, $621.6 million are rated investment grade. The Company has evaluated each of these holdings on a security-by-security basis in conjunction with its investments managers and utilizing additional corroborative modeling techniques, and believes these securities will satisfy all principal and interest payments. These securities include $305.4 million of Topical investments, $265.9 million of Core CDOs, $69.6 million of prime RMBS and $25.6 million of CMBS holdings.

Corporate securities with gross unrealized losses representing greater than 50% of amortized cost represent $494.5 million of gross unrealized losses, with a far value of $340.8 million. Of these gross unrealized losses, $394.1 million are rated investment grade. Gross unrealized losses of $238.3 million are related to holdings of financial issuers, with the majority ($190.6 million) representing hybrid instruments. The Company believes these are high-grade issuers which will continue to service their principal and interest obligations. Gross losses of $186.9 million are related to diversified notes for which the Company has evaluated the underlying collateral and believes the notes will fully perform.

As noted in Item 8, Note 2 to the Consolidated Financial Statements, Significant Accounting Policies, the determination of the amount of OTTI varies by investment type and is based upon management s periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. Management considers a wide range of factors about the security issuer and uses their best judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for near- term recovery. Inherent in management s evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Management updates its evaluations regularly and reflects additional impairments in net income as determinations are made. Management s determination of the amount of the impairment taken on investments is highly subjective and could adversely impact the Company s results of operations. There can be no assurance that management has accurately assessed the level of OTTI taken and reflected in the Company s financial statements. Furthermore, additional impairments may need to be taken in the future. Historical trends may not be indicative of future impairments.

Levels of write down or OTTI are also impacted by the Company s assessment of the intent and ability to hold securities which have declined in value until recovery. If, due to changes in circumstances, the Company determines to reposition or realign portions of the portfolio where the Company determines not to hold certain securities in an unrealized loss position to recovery, then the Company will incur OTTI charges, which charges could be significant.

Unpaid Losses and Loss Expenses

Unpaid losses and loss expenses reserves relate primarily to the casualty insurance and reinsurance business written by the Company. The balance was $21.7 billion at December 31, 2008, which is a decrease of $1.5 billion from December 31, 2007. The decrease was due primarily to favorable prior year reserve development reducing losses and loss expenses incurred during 2008 and the impact of foreign exchange rate movements. In addition, paid losses in 2008 included loss reserves associated with previous reinsurance agreements with Syncora that were settled as part of the Master Agreement.

The table below represents a reconciliation of the Company s unpaid losses and loss expenses for the year ended December 31, 2008:

(U.S. dollars in thousands)	**Gross unpaid losses and loss expenses**	**Unpaid losses and loss expenses recoverable**	**Net unpaid losses and loss expenses**
Balance at December 31, 2007	$ 23,207,694	$ (4,665,615)	$ 18,542,079
Losses and loss expenses incurred	4,695,258	(732,360)	3,962,898

Losses and loss expenses paid/recovered (1)	(5,559,039)	1,366,542	(4,192,497)
Incurred case losses and unwind of discount on reserves associated with reinsurance agreements with Syncora	50,663		50,663
Foreign exchange and other	(744,261)	66,597	(677,664)
Balance at December 31, 2008	$ 21,650,315	$ (3,964,836)	$ 17,685,479

(1) Includes paid losses relating to loss reserves associated with previous reinsurance agreements with Syncora that were settled as part of the Master Agreement.

While the Company reviews the adequacy of established reserves for unpaid losses and loss expenses regularly, no assurance can be given that actual claims made and payments related thereto will not be in excess of the amounts reserved. In the future, if such reserves develop adversely, such deficiency would have a negative impact on future results of operations. See Item 1, Unpaid Losses and Loss Expenses , Critical Accounting Policies and Estimates and Item 8, Note 12 to the Consolidated Financial Statements, Losses and Loss Expenses , for further discussion.

Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. While reinsurance agreements are designed to limit the Company s losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve the Company of its ultimate liability to the Company s insureds. Accordingly, the losses and loss expense reserves on the balance sheet represent the Company s total unpaid gross losses. Unpaid losses and loss expense recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

Unpaid losses and loss expense recoverables were $4.0 billion and $4.7 billion at December 31, 2008, and 2007, respectively. At December 31, 2008 and 2007, reinsurance balances receivable were $0.6 and $0.8 billion, respectively. The table below presents the Company s net reinsurance recoverable and reinsurance balances receivable at December 31, 2008 and 2007:

(U.S. dollars in thousands)	**December 31, 2008**	**December 31, 2007**
Reinsurance balances receivable	$ 636,284	$ 872,465
Reinsurance recoverable on future policy benefits	32,886	31,856
Reinsurance recoverable on unpaid losses and loss expenses	4,079,860	4,804,209
Bad debt reserve on unpaid losses and loss expenses recoverable and reinsurance balances receivable	(187,614)	(193,128)
Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable	$ 4,561,416	$ 5,515,402

The Company has credit risk should any of its reinsurers be unable or unwilling to settle amounts due. Of the $4.6 billion total unpaid losses and loss expenses recoverable and reinsurance balances receivable at December 31, 2008, no individual reinsurer accounted for 15% or more of the total. The Company is the beneficiary of letters of credit, trust accounts and funds withheld in the aggregate amount of $2.0 billion at December 31, 2008, collateralizing reinsurance recoverables with respect to certain reinsurers. The provision for uncollectible reinsurance is required principally due to the failure of reinsurers to indemnify the Company primarily because of disputes under reinsurance contracts and insolvencies. As at December 31, 2008 and 2007, the Company had a reserve for potential non-recoveries from reinsurers of $187.6 million and $193.1 million, respectively.

Approximately 85% of the total unpaid loss and loss expense recoverable and reinsurance balances receivable (excluding collateral held) outstanding at December 31, 2008, were due from reinsurers rated A or better by S&P. The following is an analysis of the total recoverable and reinsurance balances receivable at December 31, 2008, by reinsurers owing more than 3% of such total:

Name of reinsurer	S&P s rating	% of total
Munich Reinsurance Company	AA-/Stable	13.3%
Swiss Reinsurance Company (1)	AA-/Watch Neg.	9.4%
Lloyd s Syndicates	A+/Stable	6.2%
Transatlantic Reinsurance Company	A+/Stable	3.7%
Swiss Re Frankona Rueckversicherungs AG (1)	AA-/Watch Neg.	3.3%

(1) In February 2009, the Swiss Reinsurance Company entities were downgraded by S&P to A+ (Stable).

The following table sets forth the ratings profile of the reinsurers that support the unpaid loss and loss expense recoverable and reinsurance balances receivable net of security noted above:

Standard and Poor s rating	**% of total**
AAA	8.0 %
AA	44.9 %
A	31.6 %
BBB	0.9 %
BB and below	0.1 %
Captives	11.1 %
Not Rated	0.4 %
Other	3.0 %
Total	100 %

Fair Value Measurements of Assets and Liabilities

As disclosed in Note 3 to the Consolidated Financial Statements, Fair Value Measurements , effective January 1, 2008, the Company adopted FAS 157 and has accordingly provided required disclosures by level within the fair value hierarchy of the Company s assets and liabilities that are carried at fair value. As defined in the hierarchy, those assets and liabilities categorized as Level 3 have valuations determined using unobservable inputs. Unobservable inputs and may include the entity s own assumptions about market participant assumptions, applied to a modeled valuation, however, this is not the case with respect to the Company s Level 3 assets and liabilities. The vast majority of the assets and liabilities classified as Level 3 are made up of those securities for which the values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not obtained to support a Level 2 classification or the Company utilized internal valuation models.

At December 31, 2008, a significant component of Level 3 assets represented either Core CDOs, totaling $614.9 million, or securities within the Company s portfolio of Topical Assets, totaling $49.8 million. Certain asset classes, primarily consisting of privately placed investments, did not have sufficient market corroborated information available to allow a pricing service to provide a price and accordingly the valuation was determined by the use of broker quotes. In addition, in certain instances given the market dislocation, the Company had elected to utilize Level 3 broker valuations over available pricing service valuations during the fourth quarter of 2008; however, during the latter part of 2008, fixed maturity investments were recorded based upon pricing service valuations where available resulting in transfers being recorded from Level 3 to Level 2. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments as is currently the case for certain U.S. CMOs, ABSs, CMBSs, certain collateralized debt obligations (CDOs), and other Topical Assets which include certain securities with underlying sub-prime and related residential mortgage exposures (such as sub-prime first liens and Alt-A asset backed securities) for which sufficient information, such as cash flows or other security structure or market information, was not available to enable a third party pricing service to provide a price and as such valuation is determined based on broker quotes for which sufficient information regarding the specific inputs utilized by the broker in determining the fair value was not obtained to support a Level 2 classification. In addition, as noted below, for certain CDO holdings, the Company, in the latter part of 2008, determined that internal models would be more appropriate and better representative of the fair value of these securities given that current valuations were as a result of broker bids or valuation models that used recent market trading which the Company considered to be stressed transactions. While the remainder of the Company s holdings in securities exposed to sub-prime mortgages are generally not based on quoted prices for identical securities, they are based on model-derived valuations from pricing services in which all significant inputs and significant value drivers are considered to be observable in active markets, and these securities continue to be classified within Level 2.

During the fourth quarter of 2008, the Company determined that for certain of its CDO holdings with a fair value of $483.2 million and a par value of $801.5 million, valuations were as a result of broker bids that used recent market trading which the Company considered to be stressed transactions. The markets for

CDO s have become extremely illiquid due to a number of factors including risk aversion and reduction among institutional buyers. As a result, the Company believes that current broker bids reflect loss expectations that do not reflect fair values at which willing buyers and sellers would transact. The Company determined that internal models would be more appropriate and better representative of the fair value these securities would be sold at in an orderly market. Although similar conditions exist in other portions of the Company s holdings, primarily RMBS, the Company believes that there was only sufficient and robust historical data covering previously stressed market conditions in its CLO portfolio.

The Company s internal models resulted in a fair value that was $211.7 million higher than those that would have been determined by its previous methodology of utilizing third party values sourced through brokers or pricing services. This variance represents 26.4% of par value of these holdings, which based on the portfolio s spread duration of 4.7 years corresponds to a 560 basis point decrease relative to the spread levels implied in current market levels of trading which management believes are distressed trades. The Company believes that, in the aggregate, this is appropriate as compared to current estimates of market credit spreads.

The Company s approach for determining its CLO portfolio fair value was to apply a 60% weighting to three scenarios that the Company considered as extreme, and 40% weighting to a scenario that the Company viewed as likely. This resulted in a valuation that was based primarily on extreme loss outcomes, which the Company does not believe are likely, but recognizes as a possibility that an orderly market would price into its credit assessments given the level of uncertainty currently in the market. The individual components can be summarized as follows:

60% extreme loss outcomes:

20% weighting to current third party valuations, with a fair value of $271.5 million, which the Company believes includes the current market liquidity premium;

20% weighting to current cash flow estimates discounted at managements view of current market spreads, with a fair value of $316.8 million, which the Company believes includes the current market liquidity premium;

20% weighting to current cash flow estimates, adjusted to double the current underlying loss estimates, discounted at the coupon of the securities, with a further reduction in value representing a liquidity premium equal to double the prevailing total credit spread levels of the most severe previous CLO market deterioration, which resulted in a fair value of $410.1 million; and

40% weighting to likely loss outcomes, representing current cash flow estimates discounted at the coupon of the securities, with a further reduction in value representing a liquidity premium equal to the prevailing credit spread levels of the most severe previous CLO market deterioration, which resulted in a fair value of $702.0 million.

While a number of the Level 3 investments have been written down as a result of the Company s impairment analysis, the Company continues to report, at December 31, 2008, gross unrealized losses of $535.0 million related to Level 3 available-for-sale investments. Management completed a detailed review; in conjunction with its external investment managers and third party advisors, of the Company s underlying sub-prime and related residential mortgage exposures, as well as a consideration of the broader structured credit market, and concluded that the unrealized gains and losses in these asset classes are the result of a decrease in value due to technical spreads widening and broader market sentiment, rather than fundamental collateral deterioration and are temporary in nature.

The remainder of the Level 3 assets relate to private equity investments where the nature of the underlying assets held by the investee include positions such as private business ventures and are such that significant Level 3 inputs are utilized in the valuation, and certain derivative positions.

Controls over Valuation of Financial Instruments

The Company performs quarterly reviews of the prices received from its third party valuation sources to assess if the prices represent a reasonable estimate of the fair value. This process is completed by investment and accounting personnel who are independent of those responsible for providing the valuations. The approaches taken to gain comfort include, but are not limited to, valuation comparisons between external sources and completing recurring reviews of third party pricing services methodologies. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon available market data, the price received from one third party may be substituted for another, or in limited circumstances management may determine that an adjustment is required to a third party value. In addition, similar valuation controls are followed by external parties responsible for sourcing appropriate valuations from third parties on the Company s behalf which provides additional comfort over the reasonableness of the fair values recorded in the Company s financial statements.

Valuation Methodology of Level 3 Assets and Liabilities

Refer to Notes 2 and 3 of the Consolidated Financial Statements, Significant Accounting Policies and Fair Value Measurements for a description of the valuation methodology utilized to value Level 3 assets and liabilities, how the valuation methodology is validated as well as further details associated with various assets classified as Level 3. As at December 31, 2008, the Company did not have any liabilities that were carried at fair value based on Level 3 inputs other than derivative instruments in a liability position at December 31, 2008.

Fair Value of Level 3 Assets and Liabilities

At December 31, 2008, the fair value of Level 3 assets and liabilities as a percentage of the Company s total assets and liabilities that are carried at fair value was as follows:

(U.S. dollars in thousands) *(Unaudited)*	**Total Assets and Liabilities Carried at Fair Value at December 31, 2008**	**Fair Value of Level 3 Assets and Liabilities**	**Level 3 Assets and Liabilities as a Percentage of Total Assets and Liabilities Carried at Fair Value, by class**
Assets			
Fixed maturities, at fair value	$ 25,636,368	$ 951,879	3.7 %
Equity securities, at fair value	361,819		0.0 %
Short term investments, at fair value	1,466,323	20,746	1.4 %
Total investments available for sale	$ 27,464,510	$ 972,625	3.5 %
Cash equivalents (1)	2,310,274		0.0 %
Other investments (2)	364,679	65,354	17.9 %
Other assets (3)	122,956	314,906	256.1 %
Total assets carried at fair value	$ 30,262,419	$ 1,352,885	4.5 %
Liabilities			
Financial instruments sold, but not yet purchased (4)	$ 26,536	$	0.0 %
Other liabilities (5)	75,957	88,088	116.0 %

Total liabilities carried at fair value	$ 102,493	$ 88,088	85.9 %

(1) Cash equivalents balances subject to fair value measurements include certificates of deposit and money market funds.

(2) The other investments balance excludes certain unrated tranches of collateralized loan obligations which are carried under the cost recovery method given the uncertainty of future cash flows, as well as certain investments in project finance transactions which are carried at amortized cost. See Note 2 of the Consolidated Financial Statements for further details.

(3)

Other assets include derivative instruments, reported on a gross basis.

(4) Financial instruments sold, but not yet purchased are included within Net receivable (payable) for investments sold (purchased) on the balance sheet.

(5) Other liabilities include derivative instruments, reported on a gross basis.

As at December 31, 2008, the balance of Level 3 assets as a percentage of the Company s total assets that were carried at fair value was 4.5%. The comparable percentage at December 31, 2007 was 3.7%. The increase was primarily as a result of a change in the mix of assets during 2008 due to the sale of investments associated with the settlement of the entire GIC portfolio and certain funding agreements during 2008. Partially offsetting the increase was decreases as a result of the Company, during the latter part of 2008, recording the fair value of fixed maturity investments based upon pricing service valuations where available, resulting in transfers being recorded from Level 3 to Level 2. For further discussion of the Company s liquidity and available capital resources see Liquidity and Capital Resources , below.

Changes in the Fair Value of Level 3 Assets and Liabilities

See Note 3 of the Consolidated Financial Statements, Fair Value Measurements , for an analysis of the change in fair value of Level 3 Assets and Liabilities.

Liquidity and Capital Resources

Liquidity is a measure of the Company s ability to generate sufficient cash flows to meet the short- and long-term cash requirements of the Company s business operations.

As an insurance company, one of the Company s principal responsibilities to its clients is to ensure that the Company has ready access to funds to settle large unforeseen claims. The Company would generally expect that positive cash flow from operations (underwriting activities and investment income) will be sufficient to cover cash outflows under most future loss scenarios. However, there is a possibility that unforeseen demands could be placed on the Company due to unforeseen events and as such the Company s liquidity needs may change. Such events include, among other things, several significant catastrophes occurring in a relatively short period of time resulting in material incurred losses; rating agency downgrades of the Company s core insurance and reinsurance subsidiaries which would require posting of collateral, return of unearned premium and/or the settlement of derivative transactions; large scale uncollectible reinsurance recoverables on paid losses (as a result of coverage disputes, reinsurers credit problems or decreases in the value of collateral supporting reinsurance recoverables), etc. Any one of or a combination of such events may cause a liquidity strain for the Company. In addition, a liquidity strain could also occur in an illiquid market, such as that which was experienced in 2008 and which has continued into 2009. Investments that may be used to meet liquidity needs in the event of a liquidity strain may not be liquid, given inactive markets, or may have to be sold at a significant loss as a result of depressed prices. Because each subsidiary focuses on a more limited number of specific product lines than is collectively available from the consolidated group of companies, the mix of business tends to be less diverse at the subsidiary level. As a result, the probability of a liquidity strain, as described above, may be greater for individual subsidiaries than when liquidity is assessed on a consolidated basis. If such a liquidity strain were to occur in a subsidiary, XL Capital Ltd may be required to contribute capital to the particular subsidiary and/or curtail dividends from the subsidiary to support holding company operations.

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

Holding Company Liquidity

As a holding company, XL Capital Ltd has no operations of its own and its assets consist primarily of its investments in its subsidiaries. Accordingly, XL Capital Ltd s future cash flows depend on the availability of dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries and states in which XL Capital Ltd s subsidiaries operate, including, among others, Bermuda, New York, Ireland, Switzerland and the United Kingdom. See Item 8, Note 26 to the Consolidated Financial Statements, Statutory

Financial Data , for further discussion and details regarding dividend capacity of the Company s major operating subsidiaries. See Risk Factors Risks Related to the Company Because we are a holding company, if our subsidiaries do not make dividend and other payments to us, we may not be able to pay dividends or make payments on our debt securities and other obligations in Item 1A. The ability to pay such dividends is also limited by the regulations of the Society of Lloyd s and certain contractual provisions. No assurance can be given that the Company s subsidiaries will pay dividends in the future to XL Capital Ltd. Subsequent to December 31, 2008, dividends of approximately $620 million were paid to XL Capital Ltd. from various subsidiaries.

XL Capital Ltd s principal uses of liquidity are for dividend payments to holders of its ordinary shares and preferred shares, interest and principal payments on debt, capital investments in its subsidiaries and corporate operating expenses.

XL Capital Finance (Europe) plc (XLFE) is a wholly owned finance subsidiary of the XL Capital Ltd. In January 2002, XLFE issued $600 million par value 6.5% Guaranteed Senior Notes due January 2012. These notes are fully and unconditionally guaranteed by XL Capital Ltd.

The Company and its subsidiaries provide no guarantees or other commitments (express or implied) of financial support to the Company s subsidiaries or affiliates, except for such guarantees or commitments that are in writing.

See Consolidated Statements of Cash Flows in Item 8, Financial Statements and Supplementary Data.

Sources of Liquidity for the Company

As at December 31, 2008, the Company had cash and cash equivalents of approximately $4.4 billion as compared to approximately $3.9 billion at December 31, 2007. There are three main sources of cash flows for the Company those provided by operations, investing activities and financing activities.

Operating Cash Flows

Historically, cash receipts from operations, consisting of premiums and investment income, generally have provided sufficient funds to pay losses as well as operating expenses of the Company s subsidiaries and to fund dividends to XL Capital Ltd. Cash receipts from operations is generally derived from the receipt of investment income on the Company s total investment portfolio as well as the net receipt of premiums less claims and expenses related to the Company s underwriting activities in its property and casualty operations as well as its Life Operations segment. The Company s operating subsidiaries provide liquidity in that premiums are generally received months or even years before losses are paid under the policies related to such premiums. Premiums and acquisition expenses are settled based on terms of trade as stipulated by an underwriting contract, and generally are received within the first year of inception of a policy when the premium is written, but can be up to three years on certain reinsurance business assumed. Operating expenses are generally paid within a year of being incurred. Claims especially for casualty business, may take a much longer time before they are reported and ultimately settled and this is why the Company establishes reserves for unpaid losses and loss expenses. Therefore, the amount of claims paid in any one year is not necessarily related to the amount of net losses incurred, as reported in the consolidated statement of income.

During the year ended 2008, net cash flows used in operating activities were $427.3 million primarily as a result of the payment of approximately $1.8 billion to Syncora under the Master Agreement. The Company funded the payment to Syncora by using proceeds from the offering of both ordinary shares and ESUs, as well as from the proceeds received following the exercise by the Company of the put option under its Mangrove Bay contingent capital facility as described below. Excluding the payment to Syncora, net cash flows from operations was approximately $1.3 billion in 2008. For the same period in 2007, net cash flows from operations was $2.2 billion. The decrease in net cash flow from operations, excluding the payment to Syncora, was primarily as a result of decreases in net premiums written in the Company s P&C operations as described above and as a result of lower net investment income related to both P&C

operations and structured products mainly due to a lower asset base and changes in the portfolio mix following the sale of assets used to settle the GIC liabilities. In addition, yields earned on investment of cash flows and reinvestment of maturing or sold securities have decreased, as prevailing market interest rates, in most major geographies, have decreased overall during the last twelve months.

Total net paid losses were $3.8 billion in each of 2008 and 2007, and $3.9 billion and 2006, respectively. Net losses incurred were $4.0 billion, $3.8 billion and $4.2 billion in 2008, 2007 and 2006, respectively.

Investing Cash Flows

Generally, positive cash flow from operations and financing activities is invested in the Company s portfolio, including affiliates or acquisition of subsidiaries.

Net cash provided by investing activities of $3.8 billion in 2008 was mainly associated with the sale and redemption of the Company s investments in fixed maturities, short-term investments and equity securities. The sales of such securities exceeded related purchases, due mainly to the sale of assets used to settle the GIC liabilities and as a result of the Company s intention to reposition its investment portfolio and increase its holdings of cash as well as government agency holdings.

Net cash used in investing activities in 2007 and 2006 was primarily related to the purchase and sale of portfolio investments, with purchases of investments exceeding the related sales and redemptions. In addition, in 2007, the Company sold a portion of its interest in Syncora, through a secondary offering for $316.3 million. However, as a result of the sale and subsequent deconsolidation of Syncora, investing cash flows were reduced by $110.8 million.

If paid losses accelerate beyond the Company s ability to fund such paid losses from current operating cash flows or events lead to negative cash flows from financing activities, the Company might need to either liquidate a portion of its investment portfolio or arrange for financing. Throughout 2008, the Company s investment portfolio has been significantly impacted by the current financial and credit crises and unprecedented market volatility, resulting in significant increases in both unrealized and realized losses. Such extreme volatility has negatively impacted market liquidity and as a result, many of the Company s assets, including certain fixed income and structured credit assets remain illiquid. However, to ensure the sufficiency of funds to settle claims, the Company holds a certain amount of invested assets in cash and short-term investments and maintains available credit facilities. The balance of cash and cash equivalents and short-term investments was $4.4 billion and $1.5 billion, respectively, at December 31, 2008. In addition, for certain insurance, reinsurance, or deposit contracts that tend to have relatively large and reasonably predictable cash outflows, the Company attempts to establish dedicated portfolios of assets that are duration-matched with the related liabilities.

Certain of the Company s invested assets are held in trust and pledged in support of insurance and reinsurance liabilities. Such pledges are largely required by the Company s operating subsidiaries that are non-admitted under U.S. state insurance regulations, in order for the U.S. cedant to receive statutory credit for reinsurance. In addition certain deposit liabilities and annuity contracts require the use of pledged assets. As at December 31, 2008 the Company had approximately $13.7 billion in pledged assets.

Financing Cash Flows

Cash flows related to financing activities include ordinary and preferred share related transactions, the payment of dividends, the issue or repayment of debt and deposit liability transactions.

In order to fund the payment of approximately $1.8 billion to Syncora under the Master Agreement and the payment of approximately $283 million to consummate the redemption of X.L. America, Inc. s 6.58% Notes, the Company raised approximately $2.8 billion in August 2008 through an issuance of both ordinary shares and ESUs. Concurrent with the execution of the Master Agreement, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003, resulting in net proceeds to the Company of approximately $500 million in exchange for the issuance by the Company of 20,000,000 Series C Preference Ordinary Shares, par value U.S. $0.01 per share (the Series C Preference Shares). For further details on these transactions, see Capital Resources , below.

In July 2008, in conjunction with the issuance of ordinary shares and ESUs as described above, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.19 per ordinary share beginning with the quarterly dividend paid in September 2008. In addition, in February 2009, the Board of Directors approved a further reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend payable in March 2009.

As noted above, the Company settled during 2008, approximately $4.0 billion of GIC liabilities through the sale of certain assets from its fixed income portfolio. In addition, $1.2 billion of funding agreements were settled during 2008. At December 31, 2007, a significant component of the investments held in the Company s Other Financial Lines segment portfolios was comprised of Topical Assets and CDOs. Liquidations necessary to fund the repayment of the GIC liabilities following the downgrade of Syncora Guarantee and the maturity of certain funding agreements, were funded through sales of assets in these portfolios as well as the general investment portfolios. Management s approach was to avoid the sale of assets where current market prices did not reflect intrinsic values or where transaction costs for liquidation were excessive. As a result, the Company continues to hold a number of the Topical Assets and CDOs and these were transferred to the general investment portfolio in exchange for those assets that were liquidated. At December 31, 2008, the remaining balance of funding agreements, excluding accrued interest of $6.6 million, was $600.0 million, with settlements scheduled as follows: $150.0 million in October 2009 and $450.0 million in August 2010. The Company continues to manage its liquidity needs through changes in the mix of its investment portfolio as well as through other available capital resources and lines of credit as noted below.

In 2007, the Company repurchased approximately $1.1 billion of ordinary shares through its share repurchase programs and issued approximately $825.0 million of ordinary shares in connection with the maturity of the purchase contracts associated with the 6.5% Equity Security Units. In addition, the Company issued Series E preference ordinary shares for $1 billion and redeemed both its Series A and Series B preference ordinary shares for $230.0 million and $287.5 million, respectively. With regards to debt transactions in 2007, the Company purchased and retired the 2009 Senior Notes for $825.0 million in connection with the 6.5% Units and issued the 2027 Senior Notes for gross proceeds of approximately $324.4 million. In 2007, dividends paid were $274.0 million for ordinary shares and $69.5 million for preferred shares. In 2007, the Company paid out $360.0 million of net cash relating to deposit liability contracts.

In 2006, the Company received $342.2 million related to the sale of a portion of its interest in Syncora through a primary offering.

The Company is considered a Well Known Seasoned Issuer (WKSI) under the rules of the SEC. The Company maintains shelf registration statement on Form S-3 and is eligible for automatically effective future registration statements for the potential offering and sale of an unlimited amount of debt and equity securities. The Registration Statement allows for the following types of securities to be offered: (i) debt securities, preferred stock, common stock, depositary shares, warrants, stock purchase contracts, stock purchase units and junior subordinated deferrable interest debentures of the Company, (ii) preferred securities of any of one or more capital trusts organized by the Company and guarantees of such securities by the Company and (iii) debt securities of XL Capital Finance (Europe) plc and guarantees of such securities by the Company.

In addition the Company maintains letter of credit facilities which provide liquidity. Details of these facilities are described below in Capital Resources.

Capital Resources

In addition to ordinary share capital, the Company depends on external sources of financing to support its underwriting activities in the form of:

a. debt;

b.

preference shares;

c. contingent capital; and

d. letter of credit facilities and other sources of collateral.

In particular, the Company requires, among other things:

sufficient capital to maintain its financial strength and credit ratings, as issued by several ratings agencies, at levels considered necessary by management to enable the Company s key operating subsidiaries to compete.

sufficient capital to enable its regulated subsidiaries to meet the regulatory capital levels required in the U.S., the U.K., Bermuda, Ireland, Switzerland and other key markets.

letters of credit and other forms of collateral that are required to be posted or deposited, as the case may be, by the Company s operating subsidiaries that are non-admitted under U.S. state insurance regulations in order for the U.S. cedant to receive statutory credit for reinsurance. The Company also uses letters of credit to support its operations at Lloyd s

revolving credit to meet short-term liquidity needs.

The following risks are associated with the Company s requirement to renew its credit facilities in future years:

the credit available from banks may be reduced resulting in the Company s need to pledge its investment portfolio to customers. This could result in a lower investment yield.

the Company may be

downgraded by one or more rating agencies which could materially and negatively impact the Company s business, financial condition, results of operations and/or liquidity.

the volume of business that the Company s subsidiaries that are not admitted in the U.S. are able to transact could be reduced if the Company is unable to renew its letter of credit facilities at an appropriate amount.

Continued consolidation within the banking industry may result in the aggregate amount of credit provided to the Company being reduced. The Company attempts to mitigate this risk by identifying and/or selecting additional banks that can participate in the credit facilities upon renewal.

a) Share Capital

At December 31, 2008, the Company had total combined common and preferred share capital of $6.6 billion. In addition to ordinary and preferred share capital, the Company depends on external sources of financing such as debt, credit facilities and contingent capital to support its underwriting activities. The continuation of the current capital and credit market disruption, as well as any future disruptions or rating agency actions, could limit the Company s ability to raise capital in the future. If the Company s sources of liquidity described above prove to be insufficient, the

Company may not be able to successfully obtain additional financing on favorable terms, or at all.

Pursuant to the Company s shelf registration statement, the Company issued 143.8 million Class A ordinary shares in August 2008 at a price of $16.00 per share, with net proceeds totaling approximately $2.2 billion. The proceeds were used to fund the payments described above in relation to the Master Agreement as well as to redeem X.L. America s 6.58% Notes as described below. In addition, proceeds were used for general corporate purposes and capital funding for certain of the Company s subsidiaries. In addition, as part of the Master Agreement, the Company issued 8,000,000 Class A ordinary shares, valued at $16.00 per share, to Syncora and its subsidiaries. The shares are subject to a registration rights agreement.

In July 2008, the Board of Directors approved a reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.19 per ordinary share beginning with the quarterly dividend paid in September 2008. In addition, in February 2009, the Board of Directors approved a further reduction in the quarterly dividend payable on the Company s Class A Ordinary Shares to $0.10 per ordinary share beginning with the quarterly dividend payable in March 2009.

The Company s Rights Plan expired in accordance with its terms on September 30, 2008. Rights to purchase Class A ordinary shares (the Rights) were distributed as a dividend at the rate of one Right for each Class A ordinary share held of record as of the close of business on October 31, 1998. Each Right entitled holders of Class A ordinary shares to buy additional ordinary shares with a value of $700 at the then current market price, at an exercise price of $350. The Rights would have been exercisable, and would have detached from the Class A ordinary shares, only if a person or group were to have acquired 20% or more of the Company s outstanding Class A ordinary shares, or were to have announced a tender or exchange offer that, if consummated, would have resulted in a person or group beneficially owning 20% or more of Class A ordinary shares. Upon a person or group without prior approval of the Board acquiring 20% or more of Class A ordinary shares, each Right would have entitled the holder (other than such an acquiring person or group) to purchase Class A ordinary shares (or, in certain circumstances, Class A ordinary shares of the acquiring person) with a value of twice the Rights exercise price upon payment of the Rights exercise price. The Company would have been entitled to redeem the Rights at $0.01 per Right at any time until the close of business on the tenth day after the Rights became exercisable.

In 2007, in connection with the maturity of the purchase contracts associated with the 6.5% Units, the Company issued 10,799,913 Class A ordinary shares for net proceeds of approximately $823.0 million, a portion of which was used to retire the 2009 Senior Notes.

On September 24, 2007, the Board of Directors of the Company approved a share repurchase program, authorizing the Company to repurchase up to $500.0 million of its Class A ordinary shares. During the year ended December 31, 2008, no share repurchases were made under the share repurchase program. As at December 31, 2008, the Company could repurchase $375.5 million of its equity securities under the share repurchase program.

In February 2009, in connection with the maturity of the purchase contracts associated with the 7.00% Units, the Company issued 11,461,080 Class A ordinary shares for net proceeds of approximately $743.1 million, which was used to retire the 2011 Senior Notes.

b) Debt

Concurrent with the issuance of Class A ordinary shares as described above and pursuant to the Company s shelf registration statement, the Company, in August 2008, issued 23.0 million 10.75% Equity Security Units (the 10.75% Units) in a public offering in order to fund payments described above in relation to the Master Agreement and remaining net proceeds were used for general corporate purposes. The Company received approximately $557.8 million in net proceeds from the sale of the 10.75% Units after deducting underwriting discounts. Each 10.75% Unit has a stated amount of $25 and consists of (a) a purchase contract pursuant to which the holder agreed to purchase, for $25, a variable number of shares of the Company s Class A Ordinary Shares on August 15, 2011 and (b) a one-fortieth, or 2.5%, ownership interest in a senior note issued by the Company due August 15, 2021 with a principal amount of $1,000 (the 2021 Senior Notes). The 2021 Senior Notes are pledged by the holders to secure their obligations under the purchase contract.

The number of shares issued under the purchase contract is contingently adjustable based on, among other things, the share price of the Company on the stock purchase date and the dividend rate of the Company. The Company will make quarterly payments at the annual rate of 2.50% and 8.25% under the purchase contracts and senior notes, respectively. For all periods reported, the Company may defer the contract payments on the purchase contract, but not the senior notes, until the stock purchase date. In August 2011, the senior notes will be remarketed whereby the interest rate on the senior notes will be reset in order to generate sufficient remarketing proceeds to satisfy the 10.75% Unit holders obligations under the purchase contracts. If the senior notes are not successfully remarketed, then the Company will exercise its rights as a secured party and may retain or dispose of the senior notes to satisfy, in full, the 10.75% Unit holders obligations to purchase its ordinary shares under the purchase contracts.

In connection with this transaction, $37.9 million, which is the estimated fair value of the purchase contract, was charged to Additional paid in capital and a corresponding liability was established. Of the $18.0 million total accrued costs associated with the issuance of the 10.75% Units, $14.7 million was charged to Additional paid in capital with the remainder deferred and amortized over the term of the senior debt.

The number of ordinary shares to be issued under each purchase contract depends on, among other things, the average market price of the ordinary shares on the settlement date. The maximum number of ordinary shares to be issued under the purchase contracts is approximately 35.9 million. The Company accounts for the effect on the number of weighted average ordinary shares, assuming dilution, using the treasury stock method. The purchase contract component of the 10.75% Units will have no effect on the number of weighted average ordinary shares, assuming dilution, except when the average market price of the Company s ordinary shares is above the threshold appreciation price of $18.88 per share. Because the average market price of the Company s ordinary shares during the period the 10.75% Units were outstanding was below this price, the shares issuable under the purchase contracts were excluded from the computation of net income per ordinary share assuming dilution for the year ended December 31, 2008.

As noted above, the Company utilized a portion of the net proceeds from the capital raising activities described above, to redeem, in August 2008, X.L. America, Inc. s $255 million 6.58% Notes. In connection with the early redemption of the 6.58% Notes, the Company incurred debt extinguishment costs of approximately $22.5 million.

At December 31, 2008, banks and investors provided the Company and its subsidiaries with $4.3 billion of debt capacity, of which $3.2 billion was utilized by the Company. These facilities consist of:

revolving credit facilities of $1.1 billion in aggregate.

senior Unsecured Notes of approximately $3.2 billion. These notes require the Company to pay a fixed rate of interest during their terms. At December 31, 2008, there were six outstanding issues of senior unsecured notes:

$745 million of the 2011 Senior Notes. These securities were a component of the 7.00% Equity Security Units (the

7.00% Units) that were publicly traded. As noted above, in February 2009, the 2011 Senior Notes were retired using the proceeds from the issuance of Class A ordinary shares in connection with the maturity of the purchase contracts associated with the 7.00% Units.

$600 million senior notes due January 2012, with a fixed coupon of 6.5%. The security is publicly traded. The notes were issued at $99.469 and gross proceeds were $596.8 million. Related expenses of the offering amounted to $7.9 million.

$600 million senior notes due September 2014, with a fixed coupon of 5.25%. The security is publicly traded. The notes were issued in two tranches of $300 million aggregate principal amount each one tranche at 99.432% and the other at 98.419%. Aggregate gross proceeds were $593.6 million. Related expenses of the offering amounted to $4 million.

$575 million of senior notes due August 2021, with a fixed coupon of 8.25%. These securities are a component of the 10.75% Units that are publicly traded. In addition to the coupon paid on the senior notes, quarterly contract adjustment payments at an annual rate of 2.50% per annum are paid on forward purchase contracts for the Company s common shares for a total distribution of 10.75% per annum. The purchase contracts mature in 2011, and the senior notes mature in 2021. In August 2011, the senior notes will be remarketed whereby the interest rate will be reset in order to generate sufficient remarketing proceeds to satisfy the 10.75% Unit holders obligations under the purchase contract.

$350 million senior notes due November 2024, with a fixed coupon of 6.375%. The security is publicly traded. The notes were issued at 100.0% and gross proceeds were $350 million. Related expenses of the offering amounted to $2 million.

$325 million of senior notes due 2027, with a fixed coupon of 6.25%. The security is publicly traded. The notes were issued at 99.805% and gross proceeds were $324.4 million. Related expenses of the offering amounted to $2.5 million.

The following tables present the Company s debt under outstanding securities and lenders commitments as at December 31, 2008:

Notes Payable and Debt *(U.S. dollars in thousands)*	**Commitment**	**In Use**	**Year of Expiry**	**Payments Due by Period** **Less than 1 Year**	**1 to 3 Years**	**3 to 5 Years**
5-year revolvers (1)	$ 1,000,000	$	2010 / 2012	$	$	$
5-year revolver	100,000		2010			
5.25% Senior Notes	745,000	745,000	2011		745,000	
6.50% Guaranteed Senior Notes	599,032	599,032	2012			600,000
5.25% Senior Notes	596,283	596,283	2014			
8.25% Senior Notes	575,000	575,000	2021			
6.375% Senior Notes	350,000	350,000	2024			
6.25% Senior Notes	324,419	324,419	2027			
	$ 4,289,734	$ 3,189,734		$	$ 745,000	$ 600,000

Commitment and In Use data represent December 31, 2008 accreted values. Payments Due by Period data represent ultimate redemption values.

(1) The 2010 and 2012 5-year

revolving credit facilities share a $1.0 billion revolving credit sublimit.

c) Preference shares

On March 15, 2007, the Company issued 1,000,000 Fixed/Floating Series E Perpetual Non-Cumulative Preference Ordinary Shares, par value $0.01 per share, with liquidation preference US$1,000 per share (the Series E Preference Shares). The Company received net proceeds of approximately $983.8 million from the offering. Until April 15, 2017, dividends on the Series E Preference Shares are payable semiannually on a non-cumulative basis, when, as and if declared by the Company s Board of Directors, on April 15 and October 15 of each year, commencing in 2007, at a fixed rate equal to 6.5% per annum on the liquidation preference. From and after April 15, 2017, dividends on the Series E Preference Shares are payable quarterly on a non-cumulative basis, when, as and if declared by the Company s Board of Directors, on January 15, April 15, July 15 and October 15 of each year at a floating rate equal to three-month LIBOR plus 2.4575% on the liquidation preference. The Series E Preference Shares are perpetual securities with no fixed maturity date and are not convertible into any of the Company s other securities.

On August 14, 2007, the Company redeemed all of its outstanding 8.0% Series A Preference Ordinary Shares (the Series A Preference Shares) for approximately $25.24 per Series A Preference Share including accrued dividends. The aggregate redemption price was approximately $232.2 million.

On November 18, 2007, the Company redeemed all of its outstanding 7.625% Series B Preference Ordinary Shares (the Series B Preference Shares) for approximately $25.26 per Series B Preference Share including accrued dividends. The aggregate redemption price was approximately $290.5 million.

Redeemable preference shares

Concurrent with the execution of the Master Agreement, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003, resulting in net proceeds to the Company of approximately $500 million in exchange for the issuance by the Company of 20,000,000 Series C Preference Ordinary Shares, par value U.S. $0.01 per share (the Series C Preference Shares). The liquidation preference of the Series C Preference Shares is $25 per share, plus accrued and unpaid dividends. The Company may redeem the Series C Preference Shares, in whole or in part, on or after July 15, 2013, at a redemption price of $25 per share, plus accrued and unpaid dividends. The Company may, under certain circumstances, redeem the Series C Preference Shares before July 15, 2013 at specific redemption prices, plus accrued and unpaid dividends. These circumstances include an amalgamation, consolidation or other similar transaction involving the Company in which the Series C Preference Shares are entitled to a class vote ($26 per share redemption price), or a change in tax laws that requires the Company to pay additional amounts with respect to the Series C Preference Shares ($25 per share redemption price). The Series C Preference Shares may be redeemed by the holders after July 15, 2033. Until July 15, 2013, dividends on the Series C Preference Shares are payable semiannually on a cumulative basis, when, as and if declared by the Company s Board of Directors, on January 15 and July 15 of each year at a fixed rate equal to 6.102% per annum on the liquidation preference. From and after July 15, 2013, dividends on the Series C Preference Shares are payable quarterly on a cumulative basis, when, as and if declared by the Company s Board of Directors, on January 15, April 15, July 15 and October 15 of each year at a floating rate equal to three-month LIBOR plus 3.145% on the liquidation preference. The Series C Preference Shares have no stated maturity and are not subject to any sinking fund or mandatory redemption and are not convertible into any of the Company s other securities. On February 27, 2009, the Company initiated a cash tender offer for all of the outstanding Series C Preference Shares.

d) Contingent Capital

In addition to funded debt transactions, the Company has previously entered into contingent capital transactions. As noted above, in August 2008, the Company exercised the put option under its Mangrove Bay contingent capital facility entered into in July 2003, resulting in net proceeds to the Company of approximately $500 million in exchange for the issuance by the Company of 20,000,000 Series C Preference Shares.

At December 31, 2008, the Company has one contingent capital transaction where the outstanding put option has not been exercised. No up-front proceeds were received by the Company under this transaction, however, in the event that the associated irrevocable put option agreement is exercised, proceeds previously raised from investors from the issuance of pass-through trust securities would be received in return for the issuance of preferred shares. See below for further details on this transaction.

On December 5, 2006, the Company and certain operating subsidiaries (Ceding Insurers) entered into a securities issuance agreement (the Securities Issuance Agreement), and certain of its foreign insurance and reinsurance subsidiaries (Ceding Insurers) entered into an excess of loss reinsurance agreement (the Reinsurance Agreement), Stoneheath Re (Stoneheath). The net effect of these agreements to the Company is the creation of a contingent put option to issue $350.0 million of preference ordinary shares in the aggregate. The agreements provide the Company with a Reinsurance Collateral Account in support of certain Covered Perils named in the Reinsurance Agreement. The Covered Perils include United States wind, European wind, California earthquake and terrorism worldwide. After an initial three-month period, the covered perils as well as the attachment points and aggregate retention amounts may be changed by the Ceding Insurers in their sole discretion. This may result in a material increase or decrease in the likelihood of payment under the Reinsurance Agreement. On each date on which a Ceding Insurer withdraws funds from the Reinsurance Collateral Account, the Company shall issue and deliver to Stoneheath an amount of XL Capital Ltd Series D Preference Shares (the XL Preferred Securities) having an aggregate liquidation preference that is equal to the amount of funds so withdrawn from the Collateral Account. The Company is obligated to reimburse Stoneheath for certain fees and ordinary expenses. The initial term of the Reinsurance Agreement will be for the period from the Closing Date through June 30, 2007, with four annual mandatory extensions through June 30, 2011 (unless coverage is exhausted thereunder prior to such date). The Ceding Insurers may thereafter extend the Reinsurance Agreement at their option for additional calendar quarters without limit (unless coverage is exhausted there under). The contingent put option is recorded at fair value with changes in fair value recognized in earnings. The XL Preferred Securities, if issued, will pay dividends on a non-cumulative basis at a fixed rate of 6.868% per annum through October 15, 2011 and thereafter at a floating rate based on 3-month LIBOR, plus 3.12%.

e) Letter of Credit Facilities and other sources of collateral

At December 31, 2008, the Company had six letter of credit facilities in place with total availability of $6.9 billion, of which $3.7 billion was utilized.

Other Commercial Commitments *(U.S. dollars in thousands)*	**Commitment**	**In Use**	**Year of Expiry**	**Amount of Commitment Expiration per period** **Less than 1 Year**	**1 to 3 Years**	**3 to Yea**
Letter of Credit Facility	$ 150,000	$ 142,783	Continuous	$ 150,000	$	$
Letter of Credit Facility (1)	2,250,000		2010		2,250,000	
Letter of Credit Facility (1)	4,000,000	3,071,765	2012			4,0
Letter of Credit Facility	280	280	2009	280		
Letter of Credit Facility	107	107	2009	107		
Letter of Credit Facility	450,261	450,261	2009	450,261		
Six letter of credit facilities	$ 6,850,648	$ 3,665,196		$ 600,648	$ 2,250,000	$ 4,0

(1) Of the total letter of credit facilities above, $1 billion is also included in the revolvers under notes payable and debt.

Renewals of these commercial facilities are subject to the availability of credit from banks utilized by the Company, or other financial institutions. In the event that such credit support is insufficient, the Company could be required to provide alternative security to cedants. This could take the form of insurance trusts supported by the Company s investment portfolio or funds withheld (amounts retained by ceding companies to collateralize loss or premium reserves) using the Company s cash resources or combinations thereof. The face amount of letters of credit required is driven by, among other things, loss development of existing reserves, the payment pattern of such reserves, the expansion of business written by the Company and the loss experience of such business. In addition to letters of credit, the Company has established insurance trusts in the U.S. that provide cedants with statutory credit for reinsurance under state insurance regulation in the U.S.

The Company reviews current and projected collateral requirements on a regular basis, as well as new sources of collateral. Management s objective is to maintain an excess amount of collateral sources over expected uses. The Company also reviews its liquidity needs on a regular basis.

The following letter of credit facilities were originated, renewed or terminated during 2008:

On November 30, 2008, the £450 million letter of credit facility issued on November 14, 2007 that was supporting the Company s syndicates at Lloyd s of London terminated. However, this facility was structured so that the letters of credit issued on it are effective and support the syndicates for the 2009 underwriting year.

Cross-Default and Other Provisions in Debt Instruments

The following describes certain terms of the documents referred to below. All documents referred to below have been filed with the SEC and should be referred to for an assessment of the complete contractual obligations of the Company.

In general, all of the Company s bank facilities, indentures and other documents relating to the Company s outstanding indebtedness, including the credit facilities discussed above (collectively, the Company s Debt Documents), contain cross default provisions to each other and the Company s Debt Documents contain affirmative covenants. These covenants provide for, among other things, minimum required ratings of the Company s insurance and reinsurance operating subsidiaries and the level of secured indebtedness in the future. In addition, generally each of the Company s Debt Documents provide for an event of default in the event of a change of control of the Company or some events involving bankruptcy, insolvency or reorganization of the Company.

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

Under the Company s 2-year Lloyd s and five-year U.S. credit facilities placement notes described above, in the event that the XL Capital Group, XL Insurance (Bermuda) Ltd and XL Re Ltd fail to maintain a financial strength rating of at least A from A.M. Best, an event of default would occur.

The 6.5% Guaranteed Senior Notes indentures contain a cross default provision. In general, in the event that the Company defaults in the payment of indebtedness in the amount of $50.0 million or more, an event of default would be triggered under the Guaranteed Senior Notes indentures. Given that all of the Company s Debt Documents contain cross default provisions, this may result in all holders declaring such debt due and payable and an acceleration of all debt due under those documents. If this were to occur, the Company may not have funds sufficient at that time to repay any or all of such indebtedness.

In addition, the Company s unsecured Lloyd s letter of credit facility provides that, in the event that the Company s insurance and reinsurance rated operating subsidiaries in Bermuda fall below a rating of A from A.M. Best, the facility would then be required to be fully secured by the Company, at which time the Company would be required to either (i) provide an amount in cash to cover an amount equal to the aggregate letters of credit outstanding at that time or (ii) deposit assets in trust securing 105% of the aggregate letters of credit outstanding at that time.

Long-Term Contractual Obligations

The following table presents the Company s long term contractual obligations and related payments as at December 31, 2008, due by period. This table excludes further commitments of $104.5 million to the Company s related investment funds and certain limited partnerships, and letter of credit facilities of $3.7 billion. See Item 8, Note 17 to the Consolidated Financial Statements, Derivative Instruments, and Note 20 to the Consolidated Financial Statements, Commitments and Contingencies. See Item 8, Note 16 to the Consolidated Financial Statements, Notes Payable and Debt and Financing Arrangements, for further information.

Contractual Obligations *(U.S. dollars in thousands)*	**Total**	**Less than 1 year**	**1 to 3 years**	**3 to 5 years**	**More than 5 years**
Long-term debt obligations	$ 3,195,000	$	$ 745,000	$ 600,000	$ 1,850,000
Interest on long-term debt	1,061,962	114,943	306,802	193,373	446,844
Contingent capital facilities	41,600	8,320	16,640	16,640	
Equity Units	616,838	56,274	145,234	142,564	272,766

Operating lease obligations		213,403		36,316		55,028		40,268	81,791
Capital lease obligations		242,861		9,818		20,379		21,411	191,253
Deposit liabilities (1)		3,897,412		342,964		731,223		227,612	2,595,613
Future policy benefits (2)		8,824,786		333,155		662,695		685,619	7,143,317
Unpaid losses and loss expenses property and casualty operations (3)		22,064,869		4,715,387		6,173,615		3,767,633	7,408,234
Total	$	40,158,731	$	5,617,177	$	8,856,616	$	5,695,120	$ 19,989,818

(1) Deposit liabilities on the Company s Consolidated Balance Sheet at December 31, 2008 were $2,710,987. The difference from the amount included above relates to the discount on payments due in the future. The payment related to these liabilities varies primarily

based on interest rates. The ultimate payments associated with these liabilities could differ from the Company s estimate. See Item 8, Note 14 to the Consolidated Financial Statements, Deposit Liabilities, for further information.

(2) Future policy benefit reserves related to Life operations were $5,452,865 on the Company s Consolidated Balance Sheet at December 31, 2008. Amounts included above include an allowance for future premiums in respect of contracts under which premiums are payable throughout the life of the underlying policy. The

value of the discount is also included for those lines of business that have reserves where future claim payments and future premium receipts can be estimated using actuarial principles.

The timing and amounts of actual claims payments and premium receipts related to these reserves vary based on the underlying experience of the portfolio. Typical elements of the experience include mortality, morbidity and persistency. The ultimate amount of the claims payments and premium receipts could differ materially from the Company s estimated amounts.

(3) The unpaid loss and loss expenses were $21,650,315 on the Company s Consolidated Balance Sheet at December 31, 2008. The difference from the amount included above relates to the discount on certain workers

compensation and financial guarantee liabilities. The timing and amounts of actual claims payments related to these P&C and financial guarantee reserves vary based on many factors including large individual losses, changes in the legal environment, as well as general market conditions. The ultimate amount of the claims payments could differ materially from the Company s estimated amounts. For information regarding the estimates for unpaid loss and loss expenses as well as factors effecting potential payment patterns of reserves for actual and potential claims related the Company s different lines of business see Critical Accounting Policies and Estimates above. Certain lines of business written by the Company, such as excess casualty, have loss experience characterized as low frequency and high severity. This may result in significant variability in loss payment patterns and, therefore, may impact the related asset/liability investment management process. In order to be in a position, if necessary, to make these payments, the Company s liquidity requirements are supported by having revolving lines of credit facilities available to the Company and significant reinsurance programs, in addition to the Company s general high grade fixed income investment portfolio.

Variable Interest Entities and Other Off-Balance Sheet Arrangements

At times, the Company has utilized variable interest entities both indirectly and directly in the ordinary course of the Company s business. The Company invests in CDOs, and other investment vehicles that are issued through variable interest entities as part of the Company s risk asset portfolio.

On December 5, 2006, the Company and certain operating subsidiaries (Ceding Insurers) entered into a securities issuance agreement (the Securities Issuance Agreement), and certain of its foreign insurance and reinsurance subsidiaries (Ceding Insurers) entered into an excess of loss reinsurance agreement (the Reinsurance Agreement), with Stoneheath Re (Stoneheath). The net effect of these agreements to the Company is the creation of a contingent put option in the amount of $350.0 million in the aggregate.

The agreements provide the Company with a Reinsurance Collateral Account in support of certain Covered Perils named in the Reinsurance Agreement. The Covered Perils include United States wind, European wind, California earthquake and terrorism worldwide. After an initial three-month period, the covered perils as well as the attachment points and aggregate retention amounts may be changed by the Ceding Insurers in their sole discretion. This may result in a material increase or decrease in the likelihood of payment under the Reinsurance Agreement. On each date on which a Ceding Insurer withdraws funds from the Reinsurance Collateral Account, the Company shall issue and deliver to the Issuer an amount of XL Capital Ltd Series D Preference Shares having an aggregate liquidation preference that is equal to the amount of funds so withdrawn from the Collateral Account. The Company is obligated to reimburse Stoneheath for certain fees and ordinary expenses. The initial term of the Reinsurance Agreement was for the period from the Closing Date through June 30, 2007, with four annual mandatory extensions thereafter through June 30, 2011 (unless coverage is exhausted there under prior to such date). The Ceding Insurers may thereafter extend the Reinsurance Agreement at their option for additional calendar quarters without limit (unless coverage is exhausted there under). The contingent put option is recorded at fair value with changes in fair value recognized in earnings. The Stoneheath preferred securities and, if issued, the XL Series D Preference Shares will pay dividends on a non-cumulative basis at a fixed rate of 6.868% per annum through October 15, 2011 and thereafter at a floating rate based on 3-month LIBOR, plus 3.12%.

Recent Accounting Pronouncements

See Item 8, Note 2 to the Consolidated Financial Statements, Significant Accounting Policies , for a discussion on recent accounting pronouncements.

Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 (PSLRA) provides a safe harbor for forward-looking statements. Any prospectus, prospectus supplement, the Company s Annual Report to ordinary shareholders, any proxy statement, any other Form 10-K, Form 10-Q or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward-looking statements that reflect the Company s current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to the Company in general, and to the

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insurance and reinsurance sectors in particular (both as to underwriting and investment matters). Statements that include the words expect, intend, plan, believe, project, anticipate, will, may and similar statements of a forward-looking nature identify forward-looking statements for purposes of the PSLRA or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. The Company believes that these factors include, but are not limited to, the following: (i) changes in ratings, rating agency policies or practices; (ii) changes in the size of the Company s claims relating to natural catastrophe losses due to the preliminary nature of some reports and estimates of loss and damage to date; (iii) trends in rates for property and casualty insurance and reinsurance (iv) the timely and full recoverability of reinsurance placed by the Company with third parties, or other amounts due to the Company; (v) the projected amount of ceded reinsurance recoverables and the ratings and creditworthiness of reinsurers may change; (vi) the timing of claims payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company; (vii) ineffectiveness or obsolescence of the Company s business strategy due to changes in current or future market conditions; (viii) increased competition on the basis of pricing, capacity, coverage terms or other factors; (ix) greater frequency or severity of claims and loss activity than the Company s underwriting, reserving or investment practices anticipate based on historical experience or industry data; (x) developments, including future volatility, in the world s credit, financial and capital markets that adversely affect the performance and valuation of XL s investments or access to such markets; (xi) the potential impact on the Company from government-mandated insurance coverage for acts of terrorism; (xii) the potential for changes to methodologies; estimations and assumptions that underlie the valuation of the Company s financial instruments that could result in changes to investment valuations; (xiii) to the Company s assumptions as to whether it has the ability and intent to hold available-for-sale securities to recovery; (xiv) developments in bankruptcy proceedings or other developments related to bankruptcies of companies insofar as they affect property and casualty insurance and reinsurance coverages or claims that the Company may have as a counterparty; (xv) availability of borrowings and letters of credit under the Company s credit facilities; (xvi) the ability of the Company s subsidiaries to pay dividends to the holding company, XL Capital Ltd.; (xvii) the potential effect of domestic and foreign regulatory developments, including those which could increase the Company s business costs and required capital levels; (xviii) changes in regulation or tax laws applicable to the Company or its subsidiaries, brokers or customers; (xix) acceptance of the Company s products and services, including new products and services; (xx) changes in the availability, cost or quality of reinsurance; (xxi) changes in the distribution or placement of risks due to increased consolidation of insurance and reinsurance brokers; (xxii) loss of key personnel; (xxiii) the effects of mergers, acquisitions and divestitures; (xiv) changes in accounting policies or practices or the application thereof; (xxv) legislative or regulatory developments including, but not limited to, changes in regulatory capital balances that must be maintained by the Company s operating subsidiaries and recent governmental actions for the purpose of stabilizing the financial markets; (xxvi) other changes in general economic conditions, including changes in interest rates, credit spreads, foreign currency exchange rates, inflation and other factors; (xxvii) the effects of business disruption or economic contraction due to war, terrorism or other hostilities; (xxviii) the outcome of the Company s review of its life operations and (xxix) the other factors set forth in the Company s other documents on file with the SEC. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following risk management discussion and the estimated amounts generated from the sensitivity and value-at-risk (VaR) analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of the Company s investment portfolio. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events of losses. See

Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Market risk represents the potential for loss due to adverse changes in the fair value of financial and other instruments. The Company is principally exposed to the following market risks: interest rate risk, foreign currency exchange rate risk; equity price risk; credit risk; legacy weather and energy-related risk, and other related market risks. For a discussion of related risks, see the risk factor titled We are exposed to significant capital markets risk related to changes in interest rates, credit spreads, equity prices and foreign exchange rates which may adversely affect our results of operations, financial condition or cash flows in Item 1A Risk Factors, above.

The Company s investment market risk arises from its investment portfolio which consists of fixed income securities, alternative investments, public equities, private investments, derivatives, other investments, and cash, denominated in both U.S. and foreign currencies, which are sensitive to changes in interest rates, credit spreads, equity prices, foreign currency exchange rates and other related market risks. The Company s fixed income and equity securities are classified as available-for-sale, and as such, changes in interest rates, credit spreads on corporate and structured credit, equity prices, foreign currency exchange rates or other related market instruments will have an immediate effect on comprehensive income or loss and shareholders equity but may not have an immediate effect on net income. Changes in interest rates, credit spreads, equity prices and other related market instruments affect consolidated net income when, and if, a security is sold or impaired.

The Company conducts its derivative activities primarily in investment-related derivatives, which may include credit derivatives, and previously within weather and energy derivatives. From time to time, the Company uses investment derivative instruments such as futures, options, interest rate swaps, credit default swaps and foreign currency forward contracts to manage the duration of its investment portfolio and foreign currency exposures and also to obtain exposure to a particular financial market. The Company s derivative transactions can expose or have exposed the Company to credit derivative risk, weather and energy risk, foreign currency exchange rate risk, etc. The Company attempts to manage these risks based on guidelines established by senior management and approved by the Finance and Risk Oversight Committee. Derivative instruments are carried at fair value with the resulting changes in fair value recognized in income in the period in which they occur. Credit derivatives are purchased within the Company s investment portfolio, have been sold through a limited number of contracts written as part of the Company s previous XL Financial Solutions business, and were previously entered into through the Company s prior reinsurance agreements with Syncora. Following the closing of the Master Agreement which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreement. As of December 31, 2008, the remaining credit derivative exposure outside of the Company s investment portfolio consisted of 23 contracts written by the Company that provide credit protection on senior tranches of structured finance transactions with total net par values outstanding of $639.5 million, a weighted average contractual term to maturity of 5.7 years, a total liability recorded of $28.6 million, and an average rating of AA on the underlying obligations. As of December 31, 2008, there have been no reported events of default on the underlying obligations.

This risk management discussion and the estimated amounts generated from the sensitivity and VaR analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets and changes in the composition of the Company s investment portfolio. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events of losses. See generally Cautionary Note Regarding Forward-Looking Statements in Item 2.

Interest Rate Risk

The Company s fixed income portfolio is exposed to interest rate risk. Interest rate risk is the price sensitivity of a fixed income security to changes in interest rates. A rise in interest rates generally would decrease the fair value of the

Company s investment portfolio, offset by the Company s ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates generally would increase the fair value of the Company s investment portfolio, offset by lower rates of return on funds reinvested.

The Company manages interest rate risk within the context of its overall asset liability management strategy by setting duration targets for its investment portfolio in line with the estimated duration of its liabilities, thus mitigating the overall economic effect of interest rate risk. The Company remains nevertheless exposed to accounting interest rate risk since the assets are marked to market, thus subject to market conditions, while liabilities are accrued at a static rate. The hypothetical case of an immediate 100 basis point adverse parallel shift in global bond curves as at December 31, 2008, would decrease the fair value of the Company s fixed income portfolio by approximately 4.2% or $1.3 billion.

Foreign Currency Exchange Rate Risk

Many of the Company s non-U.S. subsidiaries maintain both assets and liabilities in local currencies. Foreign currency exchange rate gains and losses arise for accounting purposes where net assets or liabilities are denominated in foreign currencies that differ from the functional currency of those subsidiaries. While unrealized foreign exchange gains and losses on underwriting balances are reported in earnings, the offsetting unrealized gains and losses on invested assets are recorded as a separate component of shareholders equity, to the extent that the asset currency does not match that entity s functional currency. This results in an accounting mismatch that will result in foreign exchange gains or loss in the consolidated statements of income depending on the movement in certain currencies. In order to improve administrative efficiencies as well as to address this accounting imbalance, the Company formed several branches with Euro and U.K. Sterling functional currencies during 2006, 2007 and 2008. Management continues to focus on attempting to limit this type of exposure in the future.

Foreign currency exchange rate risk in general is reviewed as part of the Company s risk management process. Foreign exchange contracts within the investment portfolio are utilized to manage individual portfolio foreign exchange exposures, subject to investment manager guidelines established by management. These contracts are not designated as specific hedges for financial reporting purposes and, therefore, realized and unrealized gains and losses on these contracts are recorded in income in the period in which they occur. These contracts generally have maturities of three months or less. The Company also attempts to manage the foreign exchange volatility arising on certain transactions denominated in foreign currencies. These include, but are not limited to, premium receivable, reinsurance contracts, claims payable and investments in subsidiaries.

The principal currencies creating foreign exchange risk for the Company are the British pound sterling, the Euro, the Swiss Franc, and the Canadian dollar. The Company s net notional foreign currency denominated exposure on foreign exchange contracts was $186.2 million and $341.7 million as at December 31, 2008 and 2007, respectively, with a net unrealized loss of $3.2 million and a net unrealized gain of $0.9 million as at December 31, 2008 and 2007, respectively.

Equity Price Risk

The Company s equity portfolio as well as certain derivatives and certain affiliate investments are exposed to equity price risk. Equity price risk is the potential loss arising from changes in the market value of equities. An immediate hypothetical 10% change in the value of each equity position in the Company s equity portfolio would affect the fair value of the portfolio by approximately $33.0 million as at December 31, 2008.

As at December 31, 2008, the Company s equity portfolio was approximately $330 million as compared to approximately $757 million as at December 31, 2007. This excludes fixed income fund investments and publicly traded alternative funds that generally do not have the risk characteristics of equity investments. As at December 31, 2008, the Company s allocation to equity securities was approximately 1.1% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net receivable (payable) for investments sold (purchased) as compared to approximately 1.7% as at December 31, 2007.

As at December 31, 2008, approximately 10.5% of the equity holdings was invested in U.S. companies as compared to approximately 28.8% as at December 31, 2007. As at December 31, 2008, the top ten equity holdings represented approximately 10.4% of the Company s total equity portfolio as compared to approximately 11.5% as at December 31, 2007.

For further discussion of the exporsure to equity market movements in the Company s investment portfolio see the Investment Value-at-Risk (VaR) section below.

Credit Risk

The Company s exposure to credit spreads primarily relates to market price and cash flow variability associated with changes in credit spreads. A widening of credit spreads will increase the net unrealized loss position of the investment portfolio, will increase losses associated with credit based non-qualifying derivatives where the Company assumes credit exposure, and, if issuer credit spreads increase significantly or for an extended period of time, would likely result in higher other-than-temporary impairments. Credit spread tightening will reduce net investment income associated with new purchases of fixed maturities. In addition, market volatility can make it difficult to value certain of the Company s securities if trading becomes less frequent. As such, valuations may include assumptions or estimates that may have significant period to period changes which could have a material adverse effect on the Company s consolidated results of operations or financial condition. Credit spreads on both corporate and structured securities widened during the year ended December 31, 2008, resulting in continuing depressed pricing. Continuing challenges include continued weakness in the U.S. real estate market and increased mortgage delinquencies, investor anxiety over the U.S. economy, rating agency downgrades of various structured products and financial issuers, unresolved issues with structured investment vehicles and monolines, deleveraging of financial institutions and alternative funds and a serious dislocation in the inter-bank market. If significant, continued volatility, changes in interest rates, changes in credit spreads and defaults, a lack of pricing transparency, market liquidity, declines in equity prices, and the strengthening or weakening of foreign currencies against the U.S. dollar, individually or in tandem, could have a material adverse effect on the Company s consolidated results of operations, financial condition or cash flows through realized losses, impairments, and changes in unrealized positions.

The Company s exposure to market movements related to credit risk is primarily due to its investment portfolio, receivable and ceded reinsurance balances. Within the investment portfolio, credit risk is the exposure to adverse changes in the creditworthiness of individual investment holdings, issuers, groups of issuers, industries or countries. In addition, credit risk pertains to adverse change in the creditworthiness of the Company s reinsurers and retrocessionaires, and their ability to pay certain reinsurance receivable and recoverable balances. The hypothetical case of an immediate 25 basis point increase in all the global corporate and structured credit spreads to which the Company s fixed income portfolio is exposed to at December 31, 2008 would decrease the fair value of the Company s fixed income portfolio by approximately $243.4 million. This excludes exposure to credit in the Company s alternative investments.

The Company manages credit risk in the investment portfolio, including fixed income, alternative and short term investment through the credit research performed primarily by the external investment professionals and limitations on the investment portfolio s exposure to individual credits. Credit limits for corporate exposures are based on an internal model that allows the limits to be linked to the Company s balance sheet credit risk taking capacity while also taking into consideration internal views on specific issuers and on current or expected market credit conditions. Credit limits for other sectors are derived from the corporate limits using multipliers as a way to quantify intrinsic credit quality characteristics differences with the corporate sector. Limits are reviewed annually and ensure that potential losses from individual defaults should not exceed predetermined levels.

In the investment portfolio, the Company reviews on a regular basis its issuer concentration, credit quality and compliance with established credit limits. Any issuer over its credit limits, experiencing financial difficulties, material credit quality deterioration or potentially subject to forthcoming credit quality deterioration is placed on a watch list for closer monitoring. Where appropriate, exposures are reduced or prevented from increasing.

The Company has also developed a proprietary model for the investment portfolio to assess corporate credit risk based upon its individual holdings mark-to-market exposure, credit rating, seniority in the capital structure, migration and default probabilities, durations, default correlations and loss severity given a default event. Based upon these factors and related market based inputs, the Company can estimate the credit risk of the Company s investment portfolio and its various components. Assumptions are reviewed regularly to ensure the risk estimates are reasonable and reflect underlying exposures.

The table below shows the Company s fixed income portfolio by credit rating in percentage terms of the Company s total fixed income exposure (including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) as at December 31, 2008.

	Total
AAA	53.9
AA	21.1
A	15.7
BBB	6.8
BB & below	2.4
NR	0.1
Total	100.0 %

At December 31, 2008 and 2007, the average credit quality of the Company s total fixed income portfolio was AA. The Company s $13.2 billion portfolio of government, agency, sovereign and cash holdings was rated AAA at December 31, 2008. The Company s $10.1 billion portfolio of corporates is rated A , which includes $4.6 billion of corporate financial issues which are A+ rated. The Company s $8.6 billion structured credit portfolio is AA+ rated.

The Company is closely monitoring its corporate financial bond holdings in light of the current credit market conditions. The table below summarizes the Company s significant exposures (defined as bonds issued by financial institutions with an amortized cost in excess of $50.0 million) to corporate bonds of financial issuers held within its investment portfolio, representing both amortized cost and unrealized gains (losses):

(U.S. dollars in millions)

Issuer (by Global Ultimate Parent)(1)	**Amortized Cost at December 31, 2008**	**Unrealized (Loss) at December 31, 2008**
HBOS plc	$ 211.8	$ (32.8)
Citigroup Inc.	204.3	(17.1)
Bank of America Corporation	196.0	(14.9)
The Goldman Sachs Group, Inc.	193.6	(26.6)
HSBC Holdings Plc	141.1	(12.6)
Merrill Lynch & Co., Inc.	137.6	(12.9)
Lloyds TSB Group, Plc	132.2	(32.5)
Banco Santander, S.A	130.1	(34.7)
JPMorgan Chase & Co.	117.7	(10.7)
Morgan Stanley	112.1	(10.7)
Barclays Plc	110.5	(43.2)
American International Group, Inc	102.2	(30.3)
Nationwide Building Society	101.2	(8.5)
Wells Fargo & Company	95.2	(0.2)

HM Treasury (The Royal Bank of Scotland)	92.8	(29.9)
RFS Holdings B.V. (ABN AMRO)	85.2	(7.3)
Aviva Plc	76.8	(33.9)
Northern Rock Plc	75.0	(4.1)
American Express Company	70.9	(2.5)
UBS AG	67.5	(18.0)
Royal Bank of Canada	65.9	(1.2)
Wachovia Corporation	64.0	(4.2)
Unicredit SpA	61.5	(17.0)
Australia & New Zealand Banking Group Ltd	60.7	(1.7)
Assicurazioni Generali SpA	58.2	(19.0)
Danske Bank A/S	58.1	(13.2)
BNP Paribas	57.4	(15.6)
Caisse Nationale des Caisses D Epargne et de Prevoyance (CNCEP)	55.9	(15.7)
Legal & General Group Plc	55.4	(17.0)
Credit Agricole	51.2	(12.6)

(1) Subsequent to December 31, 2008 certain mergers have been announced that may result in changing the aggregations included herein.

Within the Company s corporate financial bond holdings, the Company is further monitoring its exposures to hybrid securities, representing Tier One and Upper Tier Two securities of various financial institutions. The following table summarizes the top ten exposures to hybrid securities, representing both amortized cost and unrealized (losses):

(U.S. dollars in millions)

Issuer (by Global Ultimate Parent)	**Tier One Amortized Cost at December 31, 2008**	**Upper Tier Two Amortized Cost at December 31, 2008**	**Total Amortized Cost at December 31, 2008**	**Net Unrealized (Loss) at December 31, 2008**
Lloyds TSB Group, Plc	$ 47.0	$ 67.5	$ 114.5	$ (36.2)
Barclays, Plc	52.5	55.3	107.8	(44.2)
Banco Santander, S.A.	44.9	58.6	103.5	(34.2)
HBOS plc	49.3	31.9	81.2	(30.9)
HM Treasury (The Royal Bank of Scotland)	15.8	64.4	80.2	(28.2)
Assicurazioni Generali S.P.A.	58.2		58.2	(21.2)
Aviva, Plc	5.7	51.5	57.2	(28.6)
Danske Bank A/S	32.5	19.4	51.9	(15.1)
Credit Agricole SA	11.8	38.6	50.4	(14.1)
Unicredit S.P.A.	43.5	1.8	45.3	(17.6)
Total	$ 361.2	$ 389.0	$ 750.2	$ (270.3)

As at December 31, 2008, the top 10 corporate holdings, which exclude government guaranteed and government sponsored enterprises, represented approximately 4.7% of the total fixed income portfolio and approximately 15.1% of all corporate holdings. The top 10 corporate holdings listed below represent the direct exposure to the corporations listed below, including their subsidiaries, and excludes any securitized, credit enhanced and collateralized asset or mortgage backed securities, cash and cash equivalents, pooled notes and any over-the-counter (OTC) derivative counterparty exposures, if applicable.

Top 10 Corporate Holdings (1)	**Percentage of Total Fixed Income Portfolio (2)**
General Electric Company	0.7 %
Citigroup Inc	0.6 %
HBOS Plc (3)	0.6 %
Bank of America Corporation (4)	0.6 %
The Goldman Sachs Group, Inc	0.5 %
HSBC Holdings Plc	0.4 %
Merrill Lynch & Co., Inc (4)	0.4 %

JP Morgan Chase & Co.	0.3 %
Morgan Stanley	0.3 %
Lloyds TSB Group Plc (3)	0.3 %

(1) Corporate issuers exclude government-backed, government-sponsored enterprises and cash and cash equivalents.

(2) Including fixed maturities, short-term investments, cash and cash equivalents and net receivable (payable) for investments sold (purchased).

(3) On September 18, 2008 Lloyds Group TSB Plc announced that it had agreed to acquire HBOS Plc.

(4) On January 1, 2009 Bank of America Corporation completed its acquisition fo Merrill Lynch & Co., Inc.

As at December 31, 2008, the top 5 corporate sector exposures represented 24.6% of the total fixed income portfolio and 77.3% of all corporate holdings.

(U.S. dollars in millions)

Top 5 Sector Exposures	**Fair Value**	**Percent of Fixed Income Portfolio**
Financials	$ 4,554.1	14.3 %
Consumer, Non-Cyclical	945.0	3.0 %
Communications	806.8	2.5 %
Industrials	797.6	2.5 %

Utilities		745.4	2.3 %
Total	$	7,848.9	24.6 %

The Company also has exposure to market movement related to credit risk associated with its mortgage-backed and asset-backed securities. The table below shows the breakdown of the $8.6 billion structured credit portfolio, of which 80.7% is AAA rated:

(U.S. dollars in millions)	**Fair Value**	**Percent of Portfolio**
CMBS	$ 2,176.5	25.3 %
Agency	2,088.0	24.3 %
Whole Loans	979.5	11.4 %
Core CDO (non-ABS CDOs and CLOs)	666.4	7.7 %
Other ABS:		
ABS Auto	676.4	7.9 %
ABS Credit Cards	458.5	5.3 %
ABS Other	596.8	6.9 %
Topical:		
Sub-prime first lien	487.7	5.7 %
Alt-A	406.1	4.7 %
Second lien (including sub-prime second lien mortgages)	58.9	0.7 %
ABS CDO s with sub-prime collateral	10.6	0.1 %
Total	$ 8,605.4	100.0 %

For further discussion of the exposure to credit market movements in the Company s investment portfolio see the Investment Value-at-Risk section below.

Credit derivatives are purchased within the Company s investment portfolio, have been sold through a limited number of contracts written as part of the Company s previous XL Financial Solutions business, and were previously entered into through the Company s prior reinsurance agreements with Syncora, as described below. From time to time, the Company may purchase credit default swaps to hedge an existing position or concentration of holdings. The credit derivatives are recorded at fair value. Following the secondary sale of Syncora common shares, the Company retained some credit derivative exposures written by Syncora and certain of its subsidiaries through reinsurance agreements that had certain derivatives exposures embedded within them. Following the closing of the Master Agreement which terminated certain reinsurance and other agreements, these credit derivative exposures were eliminated by virtue of the commutation of the relevant reinsurance agreements. As of December 31, 2008, the remaining credit derivative exposure outside of the Company s investment portfolio consisted of 23 contracts written by the Company that provide credit protection on senior tranches of structured finance transactions with total net par values outstanding of $639.5 million, a weighted average contractual term to maturity of 5.7 years, a total liability recorded of $28.6 million, and an average rating of AA on the underlying obligations. As of December 31, 2008, there have been no reported events of default on the underlying obligations.

The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, alternatives and other investment funds and other institutions. Many of these transactions expose the Company to credit risk in the event of default of the Company s counterparty. In addition, with respect to secured transactions, the Company s credit risk may be exacerbated when the collateral held by the Company cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due. The

Company also has exposure to financial institutions in the form of unsecured debt instruments, derivative transactions, revolving credit facility and letter of credit commitments and equity investments. There can be no assurance that any such losses or impairments to the carrying value of these assets would not materially and adversely affect the Company s business and results of operations.

With regards to unpaid losses and loss expenses recoverable and reinsurance balances receivable, the Company has credit risk should any of its reinsurers be unable or unwilling to settle amounts due to the Company; however, these exposures are not marked to market. For further information relating to reinsurer credit risk, see Management s Discussion and Analysis of Financial Condition and Results of Operations Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable.

The Company is exposed to credit risk in the event of non-performance by the other parties to its derivative instruments in general; however, the Company does not anticipate non-performance. The difference between the notional principal amounts and the associated market value is the Company s maximum credit exposure.

Weather and Energy Risk

Prior to August 2008, the Company previously offered weather and contingent energy risk management products in insurance or derivative form to end-users and managed the risks in the OTC and exchange traded derivatives markets or through the use of quota share or excess of loss arrangements. However, as part of the Company s strategy to focus on its core Insurance and Reinsurance P&C operations, the Company, in August 2008, closed this unit and ceased writing such weather and energy risk management products.

Fair values for the Company s existing portfolio of previously written speculative natural gas derivative contracts are determined through the use of quoted market prices. As quoted market prices are not widely available in the weather derivative market, management uses available market data and internal pricing models based upon consistent statistical methodologies to estimate fair values. Estimating fair value of instruments that do not have quoted market prices requires management s judgment in determining amounts that could reasonably be expected to be received from, or paid to, a third party in respect of the contracts. The amounts could be materially different from the amounts that might be realized in an actual sale transaction. Fair values are subject to change in the near-term and reflect management s best estimate based on various factors including, but not limited to, realized and forecasted weather conditions, changes in interest rates and other market factors.

Previously, when the Company offered weather and contingent energy risk management products, the Company managed its portfolio of such products through the employment of a variety of strategies. These included geographical and directional diversification of risk exposures and direct hedging within the capital and reinsurance markets. As at December 31, 2008, the Company s VaR related to these risks did not exceed $20.0 million in any one season. The majority of existing weather and energy contracts expired at the end of 2008 with the remainder of the portfolio expected to expire by mid-2009.

Other Market Risks

The Company s private investment portfolio is invested in limited partnerships and other entities which are not publicly traded. In addition to normal market risks, these positions may also be exposed to liquidity risk, risks related to distressed investments, and risks specific to startup or small companies. As at December 31, 2008, the Company s exposure to private investments was $404.8 million representing 1.2% of the fixed income portfolio compared to $427.5 million as at December 31, 2007.

The Company s alternative investment portfolio, which is exposed to equity and credit risk as well as certain other market risks, had a total exposure of $1.1 billion making up approximately 3.2% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) at December 31, 2008, as compared to December 31, 2007, where the Company had a total exposure of $2.3 billion representing approximately 5.2% of the total investment portfolio. The VaR associated with the alternative investment portfolio at December 31, 2008 was approximately $35.6 million.

At December 31, 2008, bond and stock index futures outstanding had a net long position of $101.7 million as compared to a net short position of $384.5 million at December 31, 2007. A 10% appreciation or depreciation of the underlying exposure to these derivative instruments would have resulted in realized gains or realized losses of $10.2 million as at December 31, 2008 and $38.5 million as at December 31, 2007, respectively. The Company may reduce its exposure to these futures through offsetting transactions, including options and forwards.

Investment Value-at-Risk (VaR)

Central to the Company s market risk management framework is VaR. VaR is a statistical risk measure, calculating the level of potential losses that could be expected to be exceeded, over a specified holding period and at a given level of confidence, in normal market conditions, due to adverse movements in the investment portfolio s underlying securities and investments valuations.

The Company uses VaR as a statistical risk measure of the two main components of its investment portfolio the Asset Liability Portfolio and the Risk Portfolio. The Asset Liability Portfolio principal objectives are to support the liabilities arising from the Company s operations, to produce a steady stream of investment income and to preserve capital. The Asset Liability portfolio is invested in investment grade fixed income and cash securities (fixed income instruments maturing one year or less at the time of issuance). The Risk Portfolio principal objective is to build book value over the long term. The Risk Portfolio is invested in equity securities, below investment grade fixed income securities, alternative investment strategies and private investments.

The Company calculates the VaR of the investment portfolio using a one month time horizon and a 95% level of confidence. This means that, on average, the Company could expect marked-to-market results greater than predicted by the VaR results 5% of the time, or once every 20 months. The calculation of VaR is performed monthly using an analytical, or variance-covariance approach, based on the linear sensitivity of the portfolio and individual securities to a broad set of systematic market risk factors and idiosyncratic risk factors. The Company computes the parametric sensitivity of every security in a portfolio to changes in key interest rates, spreads, implied volatility, equities, and foreign exchange rates. The parametric exposures are summed using the appropriate portfolio weights to compute a portfolio s exposure to these systematic and idiosyncratic market risk factors. Results are expressed both in terms of U.S. dollars and as a percentage of the Company s investment portfolio.

As part of the Company s ongoing initiatives to enhance its risk reporting activities, the Company has expanded its modeling capabilities and analytics to measure the VaR of the investment portfolio excluding the foreign exchange rate risk within the investment portfolio. Within its asset liability framework for the investment portfolio, the Company pursues a general policy of holding the assets and liabilities in the same currency and as such the Company is not exposed to the risks associated foreign exchanges movements within the investment portfolio, as currency impacts on the assets are generally matched by corresponding impacts on the related liabilities, and accordingly are neutral to the Company s book value. The Company considers that the investment portfolio VaR results excluding foreign exchange rate risk are the more relevant and appropriate metrics to consider when assessing the actual risk of the investment portfolio. The Company has implemented such analysis as of December 31, 2008 and expects to report the VaR of the investment portfolio excluding foreign exchange risk in future periods. The results for December 31, 2008 are reported in the table below.

The modeling of the risk of any portfolio, as measured by VaR, involves a number of assumptions and approximations. While the Company believes that its assumptions and approximations are appropriate, there is no uniform industry methodology for calculating VaR. The Company notes that different VaR results can be produced for the same portfolio dependent not only on the approach used but also on the assumptions employed when implementing the approach.

The VaR approach uses historical data to determine the sensitivity of each of the underlying securities to the risk factors incorporated into the pricing models employed in the VaR calculations. In calculating these sensitivities, greater importance is placed on the more recent data points and information. Since the VaR approach is based on historical positions and market data, VaR results should not be viewed as an absolute and predictive gauge of future financial performance or as a way for the Company to predict risk. There is no assurance that the Company s actual future losses will not exceed its VaR and the Company expects that 5% of the time the VaR will be exceeded.

Additionally, the Company acknowledges the fact that risks associated with abnormal market events can be significantly different from the VaR results and these are by definition not reflected or assessed in the VaR analysis, rather this is evaluated using the Company s stress testing framework.

The VaR of the investment portfolio at December 31, 2008 was approximately $1.5 billion including foreign exchange rate risk and $0.9 billion excluding foreign exchange rate risk. The VaR of all investment related derivatives excluding investments in affiliates and other investments was approximately $42.9 million.

In instances where the data or time series are insufficient to determine the risk factor sensitivities, the VaR approach uses proxy time series data available for similar instruments. As at December 31, 2008, approximately $5.8 billion used proxy time series data. Approximately $1.1 billion related to various fixed income portfolios (of which $0.5 billion was in mortgage backed and asset backed securities), $3.0 billion to various cash portfolios, $1.1 billion to alternative investments, $0.4 billion to private investments, $0.1 billion to equity portfolios, and nil to derivatives. The Company reviews the proxies to ensure that an appropriate data and time series is being used in the calculations and that the proxies used are conservative.

The following table shows the Company s average, minimum and maximum VaR in percentage and dollar terms for the investment portfolio during the year ended December 31, 2008, based upon the VaR at quarter end dates. The table also includes the Company s VaR in percentage and dollar terms, respectively, for the investment portfolio as at December 31, 2008. The Company s investment portfolio VaR as at December 31, 2008 is not necessarily indicative of future VaR levels. The Company uses VaR as a statistical risk measure of the two main components of its investment portfolio only the Asset Liability Portfolio and the Risk Asset Portfolio.

	Average VaR % VaR (1)	**Minimum VaR % VaR (1)**	**Maximum VaR % VaR (1)**	**At December 31, 2008 % VaR (1)**	**At December 31, 2008 % VaR (2)**
Asset Liability Portfolio	2.70 %	1.72 %	5.22 %	5.00 %	2.87 %
Risk Asset Portfolio	3.92 %	2.69 %	5.92 %	4.82 %	4.56 %
Undiversified VaR (3	2.83 %	1.83 %	5.24 %	4.98 %	3.00 %
Diversification VaR (4)	0.29 %	%	%	0.16 %	0.21 %
Investment Portfolio VaR (5)(7)	2.54 %	1.55 %	5.07 %	4.82 %	2.79 %

(U.S. dollars in millions)	**Average VaR during 2008 $VaR (6)**	**Minimum VaR during 2008 $VaR (6)**	**Maximum VaR during 2008 $VaR (6)**	**VaR as at December 31, 2008 $VaR (6)**	**VaR as at December 31, 2008 $VaR (7)**
Investment Portfolio VaR (5)(8)	$ 880.7	$ 564.0	$ 1,603.5	$ 1,542.8	$ 892.4

(1) Based on a 95% confidence level with a one month holding period and expressed as a percentage of the investment

portfolio.

(2) Based on a 95% confidence level with a one month holding period and expressed as a percentage of the investment portfolio excluding foreign exchange rate risk as described above.

(3) Average Undiversified VaR for the year ended December 31, 2008 and Undiversified VaR at December 31, 2008 is the summation of the individual VaRs for the Asset Liability and Risk Asset portfolios and, by construction, ignores any and all correlations between these portfolios (and their underlying asset classes). The Undiversified VaR therefore ignores diversification benefits that

exist in between these portfolios (and their respective underlying asset classes). Maximum and Minimum Undiversified VaR is not necessarily the summation of the individual VaRs for each of the separate portfolios since the Maximum and Minimum VaR and the Maximum and Minimum Undiversified VaR do not necessarily refer to the same point in time.

(4) Diversification VaR equals the difference between the Investment Portfolio VaR and the Undiversified VaR. As the former explicitly accounts for the correlations and diversification benefits that exist between the Asset Liability and Risk Asset portfolios and the latter explicitly does

not, the difference in the two VaR results is due to the diversification benefits. These diversification benefits arise due to the risk reduction that occurs when different assets, that are not perfectly correlated, are combined in a portfolio. It will vary over time dependent on: changes in allocations; changes in the correlations between the different underlying asset classes; and changes in the underlying asset class risks. The NA reflects the fact that, since the Minimum and Maximum VaR do not refer to the same point in time, it is therefore not meaningful to calculate the Diversification VaR.

(5) Investment Portfolio VaR is based on the prescribed methodology that explicitly

accounts for the diversification benefits that occur when each of the allocations to the Asset Liability and Risk Asset portfolios (and their underlying asset classes) are included in the investment portfolio.

(6) Based on a 95% confidence level with a one month holding period, expressed in millions of U.S. Dollars.

(7) Based on a 95% confidence level with a one month holding period, expressed in millions of U.S. Dollars excluding foreign exchange rate risk.

(8) Investment Portfolio refers to the two main components of the Company s investment portfolio the Asset Liability Portfolio and

the Risk Asset
Portfolio.

The Company s total investment portfolio VaR is driven by: the size of the overall investment portfolio; the size of the allocations to the different asset classes and securities in the asset classes; the risks associated with each of the asset classes and securities; and the correlations and diversification benefits between each of the asset classes and securities. Changes in any of these variables will have a direct impact on the Company s VaR.

Stress Testing

VaR does not provide the means to estimate the magnitude of the loss in the 5% of occurrences that the Company expects the VaR level to be exceeded. To complement the VaR analysis based on normal market environments, the Company considers the impact on the investment portfolio in several different historical stress periods to analyze the effect of unusual market conditions. The Company establishes certain historical stress test scenarios which are applied to the actual investment portfolio. As these stress tests and estimated gains and losses are based on historical events, they will not necessarily reflect future stress events or gains and losses from such events. The results of the stress test scenarios are reviewed on a regular basis to ensure they are appropriate, based on current shareholders equity, market conditions and the Company s total risk tolerance. It is important to note that when assessing the risk of the Company s investment portfolio, the Company does not take into account either the value or risk associated with the liabilities arising from the Company s operations. Since the principal objectives of the Asset Liability portfolio component of the investment portfolio are to support and generally offset or hedge certain of the risks associated with the liabilities.

The table below shows the maximum impact on the Company s investment portfolio including the impact of foreign exchange rates if all events stress tested were to repeat themselves, given the actual investment portfolio s allocations at the quarters ended March 31, June 30, September 30 and December 31, 2008. The Company assumes that no action is taken during the stress period to either liquidate or rebalance the portfolio. The Company believes that this fairly reflects the potential decreased liquidity that is often associated with stressed market environments.

Stress Test	**March 31, 2008**	**June 30, 2008**	**September 30, 2008**	**December 31, 2008 (1)**
Maximum loss impact on portfolio	(6.2)%	(6.3)%	(4.4)%	(7.3)%
Maximum gain impact on portfolio	18.9 %	19.5 %	18.9 %	20.1 %

(1) In the fourth quarter of 2008, the Company added an additional historical stress scenario to reflect the 2008 Credit Crisis.

From the different scenarios that the Company analyzes, the largest downside event risk exposure during 2008 was 7.3%, based on the investment portfolio as at December 31, 2008. This largest downside event risk exposure of 7.3% is reflective of a new 2008 Credit Crisis stress test implemented in the fourth quarter of 2008 and assumes a repeat of the extreme volatility in the capital markets experienced the period from September 12, 2008 to November 3, 2008; the day before the Lehman bankruptcy announcement. Excluding this new stress test, the Maximum loss impact on the portfolio as of December 31 2008 was 4.8%. The largest upside risk exposure during 2008 was 20.1% as at December 31, 2008.

At December 31, 2008 the Company s maximum loss impact and maximum gain impact on the investment portfolio were at their maximum month end ranges. The higher year end results were primarily a reflection of the extreme volatility levels observed in the level of interest rates, spread levels and other key risk factors during the fourth quarter of 2008 following the bankruptcy of Lehman Brothers, Inc.

Given the investment portfolio allocations as at December 31, 2008, the Company would expect to lose approximately 7.3% of the portfolio if the most damaging event stress tested (2008 Credit Crisis) was repeated, all other things held equal. Given the investment portfolio allocations as at December 31, 2008, the Company would expect to gain approximately 20.1% of the portfolio if the most favorable event stress tested was repeated, all other things held equal.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31, 2008 AND 2007

(U.S. dollars in thousands, except share amounts)	**2008**	**2007**
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2008, $28,990,477; 2007, $34,233,816)	$ 25,636,368	$ 33,607,790
Equity securities, at fair value (cost: 2008, $337,765; 2007, $664,213)	361,819	854,815
Short-term investments, at fair value (amortized cost: 2008, $1,500,767; 2007, $1,814,445)	1,466,323	1,803,198
Total investments available for sale	27,464,510	36,265,803
Investments in affiliates	1,552,789	2,611,149
Other investments (cost: 2008, $417,856; 2007, $614,848)	459,481	708,476
Total investments	29,476,780	39,585,428
Cash and cash equivalents	4,353,826	3,880,030
Accrued investment income	363,376	447,660
Deferred acquisition costs	713,501	756,854
Prepaid reinsurance premiums	896,216	972,516
Premiums receivable	3,377,016	3,637,452
Reinsurance balances receivable	563,694	817,931
Unpaid losses and loss expenses recoverable	3,997,722	4,697,471
Net receivable from investments sold	99,455	
Goodwill and other intangible assets	853,550	1,841,591
Deferred tax asset, net	331,348	370,419
Other assets	655,521	754,912
Total assets	$ 45,682,005	$ 57,762,264
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 21,650,315	$ 23,207,694
Deposit liabilities	2,710,987	7,920,085
Future policy benefit reserves	5,452,865	6,772,042
Unearned premiums	4,217,931	4,681,989
Notes payable and debt	3,189,734	2,868,731
Reinsurance balances payable	786,463	843,511
Net payable for investments purchased		191,472
Other liabilities	1,056,879	1,326,179

Total liabilities	$	39,065,174	$	47,811,703
Commitments and Contingencies				
Minority interest in equity of consolidated subsidiaries	$	1,598	$	2,419
Redeemable Series C preference ordinary shares, 20,000,000 authorized, par value $0.01 Issued and outstanding: (2008, 20,000,000; 2007, nil)	$	500,000	$	
Shareholders Equity:				
Series E preference ordinary shares, 1,000,000 authorized, par value $0.01 Issued and outstanding: (2008, 1,000,000; 2007, 1,000,000)		10		10
Class A ordinary shares, 999,990,000 authorized, par value $0.01 Issued and outstanding: (2008, 330,812,343; 2007, 177,910,151)		3,308		1,779
Additional paid in capital		9,792,371		7,358,801
Accumulated other comprehensive (loss) income		(3,364,927)		9,159
Retained (deficit) earnings		(315,529)		2,578,393
Total shareholders equity	$	6,115,233	$	9,948,142
Total liabilities, minority interest, redeemable preference ordinary shares and shareholders equity	$	45,682,005	$	57,762,264

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(U.S dollars in thousands, except per share amounts)	2008	2007	2006
Revenues:			
Net premiums earned	$ 6,640,102	$ 7,205,356	$ 7,569,518
Net investment income	1,768,977	2,248,807	1,978,184
Net realized (losses) on investments	(962,054)	(603,268)	(116,458)
Net realized and unrealized (losses) gains on derivative instruments	(73,368)	(55,451)	101,183
Net (loss) income from investment fund affiliates	(277,696)	326,007	269,036
Fee income and other	52,158	14,271	31,732
Total revenues	$ 7,148,119	$ 9,135,722	$ 9,833,195
Expenses:			
Net losses and loss expenses incurred	$ 3,962,898	$ 3,841,003	$ 4,201,194
Claims and policy benefits	769,004	888,658	807,255
Acquisition costs	944,460	1,063,713	1,102,046
Operating expenses	1,161,934	1,144,910	1,182,939
Exchange (gains) losses	(184,454)	(19,734)	89,373
Interest expense	351,800	621,905	552,275
Extinguishment of debt	22,527		
Impairment of goodwill	989,971		
Amortization of intangible assets	2,968	1,680	2,355
Total expenses	$ 8,021,108	$ 7,542,135	$ 7,937,437
(Loss) income before minority interest, income tax and net income from operating affiliates	$ (872,989)	$ 1,593,587	$ 1,895,758
Minority interest in net income of subsidiaries		23,928	25,016
Provision for income tax	222,578	233,922	219,645
Net (loss) income from operating affiliates	(1,458,246)	(1,059,848)	111,670
Net (loss) income	$ (2,553,813)	$ 275,889	$ 1,762,767
Preference share dividends	(78,645)	(69,514)	(40,322)
	$ (2,632,458)	$ 206,375	$ 1,722,445

Net (loss) income available to ordinary shareholders

Net (loss) income	$	(2,553,813)	$	275,889	$	1,762,767
Change in net unrealized (losses) on investments, net of tax		(2,893,060)		(747,941)		(103,834)
Additional pension liability		(2,124)		3,080		(9,809)
Change in value of cash flow hedge		439		4,338		630
Change in net unrealized (loss) gain on future policy benefit reserves		(6,998)		16,005		94,904
Foreign currency translation adjustments		(472,343)		317,319		153,610
Realization of accumulated other comprehensive loss on sale of Syncora				4,953		14,224
Minority interest share in change in accumulated other comprehensive loss in Syncora						(6,563)
Comprehensive (loss) income	$	(5,927,899)	$	(126,357)	$	1,905,929
Weighted average ordinary shares and ordinary share equivalents outstanding basic		238,862		178,500		178,793
Weighted average ordinary shares and ordinary share equivalents outstanding diluted		238,862		179,693		179,450
(Loss) earnings per ordinary share and ordinary share equivalent basic	$	(11.02)	$	1.16	$	9.63
(Loss) earnings per ordinary share and ordinary share equivalent diluted	$	(11.02)	$	1.15	$	9.60

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(U.S. dollars in thousands)	**2008**	**2007**	**2006**
Series A, B, and E Preference Ordinary Shares:			
Balance beginning of year	$ 10	$ 207	$ 207
Issuance of Series E preference ordinary shares		10	
Redemption of Series A preference ordinary shares		(92)	
Redemption of Series B preference ordinary shares		(115)	
Balance end of year	$ 10	$ 10	$ 207
Ordinary Shares:			
Balance beginning of year	$ 1,779	$ 1,810	$ 1,795
Issuance of Class A ordinary shares	1,530	113	9
Exercise of stock options		9	7
Repurchase of Class A ordinary shares	(1)	(153)	(1)
Balance end of year	$ 3,308	$ 1,779	$ 1,810
Additional paid in capital:			
Balance beginning of year	$ 7,358,801	$ 6,451,569	$ 6,377,375
Issuance of Class A ordinary shares	2,393,238	874,172	56,308
Issuance of Series E preference ordinary shares		984,573	
Repurchase of Class A ordinary shares	(4,965)	(515,677)	(2,846)
Redemption of Series A preference ordinary shares		(229,908)	
Redemption of Series B preference ordinary shares		(287,385)	
Fair value of purchase contracts associated with equity security units	(37,860)		
Outstanding accrued contingent capital put premium	51,064		
Stock option expense	20,941	15,114	27,216
Exercise of stock options		65,832	33,062

Net change in deferred compensation	11,152	511	1,554
Net loss on sale of Syncora			(30,100)
Realization of accumulated other comprehensive loss on sale of Syncora			(11,000)
Balance end of year	$ 9,792,371	$ 7,358,801	$ 6,451,569
Accumulated Other Comprehensive Income:			
Balance beginning of year	$ 9,159	$ 411,405	$ 268,243
Net change in unrealized (losses) on investment portfolio, net of tax	(2,846,989)	(775,159)	(136,090)
Net change in unrealized gains on affiliate and other investments, net of tax	(46,071)	27,218	32,256
Additional pension liability	(2,124)	3,080	(9,809)
Change in value of cash flow hedge	439	4,338	630
Change in net unrealized (loss) gain on future policy benefit reserves	(6,998)	16,005	94,904
Foreign currency translation adjustments	(472,343)	317,319	153,610
Realization of accumulated other comprehensive loss on sale of Syncora		4,953	14,224
Minority interest share in change in accumulated other comprehensive loss in Syncora			(6,563)
Balance end of year	$ (3,364,927)	$ 9,159	$ 411,405
Retained (Deficit) Earnings:			
Balance beginning of year	$ 2,578,393	$ 3,266,175	$ 1,824,191
Net (loss) income	(2,553,813)	275,889	1,762,767
Dividends on Class A ordinary shares	(261,464)	(274,037)	(277,682)
Dividends on Series A, B and E preference ordinary shares	(78,645)	(69,514)	(40,322)
Repurchase of shares		(620,120)	(2,779)
Balance end of year	$ (315,529)	$ 2,578,393	$ 3,266,175
Total shareholders equity	$ 6,115,233	$ 9,948,142	$ 10,131,166

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(U.S. dollars in thousands)	**2008**	**2007**	**2006**
Cash Flows Provided by Operating Activities:			
Net (loss) income	$ (2,553,813)	$ 275,889	$ 1,762,767
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Net realized losses on sales of investments	962,054	603,268	116,458
Net realized and unrealized losses (gains) on derivative instruments	73,368	55,451	(101,183)
Amortization of (discounts) premiums on fixed maturities	(47,201)	(86,826)	(29,435)
Impairment of goodwill	989,971		
Amortization of intangible assets	2,968	1,680	2,355
Amortization of deferred compensation	57,617	49,666	56,163
Accretion of convertible debt	1,003	988	969
Accretion of deposit liabilities	146,588	421,074	350,053
Net loss (income) from investment and operating affiliates	1,735,942	733,841	(380,706)
Cash paid to Syncora	(1,775,000)		
Unpaid losses and loss expenses	(849,069)	(231,400)	(1,290,840)
Unearned premiums	(266,732)	(230,834)	130,836
Premiums receivable	111,789	33,879	341,720
Unpaid losses and loss expenses recoverable	644,968	387,263	1,562,453
Future policy benefit reserves	30,996	93,668	105,395
Prepaid reinsurance premiums	33,350	173,123	(89,037)
Reinsurance balances receivable	239,052	307,432	(32,782)
Reinsurance balances payable	(13,229)	(78,486)	(528,697)
Deferred acquisition costs	(29,583)	3,925	21,479
Deferred tax asset	129,890	(20,100)	20,729
Accrued investment income	48,252	(18,373)	(22,140)
Other assets	(53,450)	(324,368)	382,766
Other liabilities	(210,483)	12,227	(141,064)
Other	163,492	77,879	200,396
Total adjustments	$ 2,126,553	$ 1,964,977	$ 675,888

Net cash (used in) provided by operating activities	$ (427,260)	$ 2,240,866	$ 2,438,655
Cash Flows Provided By (Used In) Investing Activities:			
Proceeds from sale of fixed maturities and short-term investments	$ 13,692,768	$ 23,570,285	$ 24,409,164
Proceeds from redemption of fixed maturities and short-term investments	3,065,326	1,923,459	1,451,695
Proceeds from sale of equity securities	866,346	937,994	1,130,234
Net proceeds from sale of Syncora common shares			104,650
Proceeds from sale of Syncora common shares, net of cash sold upon de-consolidation		(110,843)	
Purchases of fixed maturities and short-term investments	(13,620,024)	(25,229,000)	(29,141,948)
Purchases of equity securities	(659,911)	(832,385)	(1,000,775)
Net dispositions of affiliates and dividends received	384,130	77,500	155,358
Acquisition of subsidiaries, net of cash acquired		(32,918)	(12,600)
Other investments	80,598	(185,734)	(72,190)
Other assets			4,087
Net cash provided by (used in) investing activities	$ 3,809,233	$ 118,358	$ (2,972,325)

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006 (Continued)

(U.S. dollars in thousands)	2008	2007	2006
Cash Flows (Used in) Provided by Financing Activities:			
Proceeds from issuance of Class A ordinary shares and exercise of stock options	$ 2,231,000	$ 878,439	$ 31,972
Proceeds from issuance of Series C redeemable preference ordinary shares	500,000		
Proceeds from issuance of Series E preference ordinary shares		984,583	
Redemption of Series A preference ordinary shares		(230,000)	
Redemption of Series B preference ordinary shares		(287,500)	
Repurchase of Class A ordinary shares	(4,966)	(1,135,950)	(5,626)
Dividends paid on Class A ordinary shares	(261,373)	(274,037)	(277,682)
Dividends paid on preference ordinary shares	(65,000)	(69,514)	(40,322)
Proceeds from issuance of debt	557,750	322,836	
Repayment of debt	(255,000)	(825,000)	(45,291)
Deposit liabilities	(5,628,177)	(360,029)	(734,185)
Net cash flow on securities lending	96,469	10,191	(239,281)
Proceeds from issuance of Syncora common shares			342,227
Proceeds from issuance of Syncora Series A perpetual preference ordinary shares		247,248	
Dividends paid to minority shareholders of Syncora		(16,130)	
Net cash (used in) provided by financing activities	$ (2,829,297)	$ (754,863)	$ (968,188)
Effects of exchange rate changes on foreign currency cash	(78,880)	51,921	32,131
Increase (decrease) in cash and cash equivalents	473,796	1,656,282	(1,469,727)
Cash and cash equivalents beginning of year	3,880,030	2,223,748	3,693,475
Cash and cash equivalents end of year	$ 4,353,826	$ 3,880,030	$ 2,223,748
Net taxes paid	$ 154,216	$ 156,315	$ 194,217

Interest paid	$	181,944	$	171,677	$	170,286

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

1. General

XL Capital Ltd, through its operating subsidiaries (collectively the Company or XL), is a leading provider of insurance and reinsurance coverages to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The Company and its various subsidiaries operate globally in 28 countries, through its four business segments: Insurance, Reinsurance, Life Operations, and Other Financial Lines. These segments are further discussed in Note 6 to the Consolidated Financial Statements, Segment Information.

2. Significant Accounting Policies

(a) Basis of Preparation and Consolidation

These consolidated financial statements include the accounts of the Company and all of its subsidiaries. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All significant intercompany accounts and transactions have been eliminated. Certain amounts in 2007 and 2006 have been reclassified to conform to the current year presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount 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. The Company s most significant areas of estimation include:

- unpaid losses and loss expenses and unpaid losses and loss expenses recoverable;
- future policy benefit reserves;
- deposit liabilities;
- valuation of certain derivative instruments;
- other than temporary impairments in the value

of investments;

income taxes;

reinsurance premium estimates; and

goodwill carrying value.

While management believes that the amounts included in the consolidated financial statements reflect the Company s best estimates and assumptions, actual results could differ from these estimates.

(b) Fair Value Measurements

Financial Instruments subject to Fair Value Measurements

In September 2006, the FASB issued No. FAS 157, Fair Value Measurements (FAS 157). FAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under FAS 157, fair value measurements are not adjusted for transaction costs. FAS 157 nullifies the guidance included in EITF Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, that prohibited the recognition of a day one gain or loss on derivative contracts (and hybrid financial instruments measured at fair value under FAS 155) where a company was unable to verify all of the significant model inputs to observable market data and/or verify the model to market transactions. However, FAS 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model.

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(b) Fair Value Measurements (Continued)

In addition, FAS 157 prohibits the recognition of block discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available for an identical asset or liability in an active market. The provisions of FAS 157 are to be applied prospectively, except changes in fair value measurements that result from the initial application of FAS 157 to existing derivative financial instruments measured under EITF Issue No. 02-3, existing hybrid financial instruments measured at fair value and block discounts, all of which are to be recorded as an adjustment to beginning retained earnings in the year of adoption.

The Company adopted FAS 157 as of January 1, 2008, applying the provisions of the statement prospectively to assets and liabilities measured at fair value. There was no transition adjustment required to opening retained earnings as a result of the adoption of this standard. As noted above, the fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Instruments that the Company owns (long positions) are marked to bid prices and instruments that the Company has sold but not yet purchased (short positions) are marked to offer prices. Fair value measurements are not adjusted for transaction costs.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2), which permits a one-year deferral of the application of FAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 is effective in conjunction with FAS 157 for interim and annual financial statements issued after January 1, 2009. Accordingly, the provisions of FAS 157 have not been applied to goodwill and other intangible assets held by the Company which are measured periodically for impairment testing purposes only.

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS 157-3). This FSP clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in the determination of the fair value of a financial asset when the market for that asset is not active. The key considerations illustrated in the FSP FAS 157-3 example include the use of an entity s own assumptions about future cash flows and appropriately risk-adjusted discount rates, appropriate risk adjustments for nonperformance and liquidity risks, and the reliance that an entity should place on quotes that do not reflect the result of market transactions. FSP FAS 157-3 was preceded by a press release that was jointly issued by the Office of the Chief Accountant of the SEC and the FASB staff on September 30, 2008 which provided immediate clarification on fair value accounting based on the measurement guidance of FAS 157. FSP FAS 157-3 was effective upon issuance. The Company determined that applying the principles of FSP FAS 157-3 with respect to the CLO portfolio was appropriate.

Basis of Fair Value Measurement

FAS 157 also establishes a fair value hierarchy that prioritizes the inputs to the respective valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). An asset s or liability s classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The three levels of the fair value hierarchy under FAS 157 are described further below:

Level 1 Quoted prices in active markets for identical assets or liabilities (unadjusted); no blockage factors.

Level 2 Other observable inputs (quoted prices in markets that are not active or inputs that are observable either directly or indirectly) include quoted prices for similar assets/liabilities (adjusted) other than quoted prices in Level 1; quoted prices in markets that are not active; or other inputs that

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(b) Fair Value Measurements (Continued)

are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Unobservable inputs reflect the reporting entity s own assumptions about the assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Details on assets and liabilities that have been included under the requirements of FAS 157 to illustrate the bases for determining the fair values of the assets and liabilities held by the Company are detailed in each respective significant accounting policy section of this note.

Fair values of investments and derivatives are based on published market values if available, estimates of fair values of similar issues, estimates of fair values provided by independent pricing services or estimates of fair values determined by the Company. Fair values of financial instruments for which quoted market prices are not available or for which the Company believes current trading conditions represent distressed transactions are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rates and the estimated amounts and timing of future cash flows. In such instances, the derived fair value estimates cannot be substantiated by comparison to independent markets and are not necessarily indicative of the amounts that would be realized in a current market exchange. Certain financial instruments, particularly insurance contracts, are excluded from fair value disclosure requirements of FAS 107, Disclosures about Fair Value of Financial Instruments. For further information on accounting policies relating to other financial instruments, investments, other investments, notes payable and debt, derivative instruments, and off-balance sheet arrangements, see Notes 3, 9, 11, 16, 17, and 18, respectively.

(c) Premiums and Acquisition Costs

Insurance premiums written are recorded in accordance with the terms of the underlying policies. Reinsurance premiums written are recorded at the inception of the policy and are estimated based upon information received from ceding companies and any subsequent differences arising on such estimates are recorded in the period they are determined. Financial guarantee installment premiums are recorded as premiums written when due.

Premiums are earned on a pro-rata basis over the period the coverage is provided. Financial guarantee insurance premiums are earned pro-rata to the amount of risk outstanding over the life of the exposure. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of policies in force. Net premiums earned are presented after deductions for reinsurance ceded, as applicable.

Mandatory reinstatement premiums are recognized and earned at the time a loss event occurs.

Life and annuity premiums from long duration contracts that transfer significant mortality or morbidity risks are recognized as revenue and earned when due from policyholders. Life and annuity premiums from long duration contracts that do not subject the Company to risks arising from policyholder mortality or morbidity are accounted for as investment contracts and presented within deposit liabilities.

The Company writes retroactive loss portfolio transfer (LPT) contracts. These contracts are evaluated to determine whether they meet the established criteria for reinsurance accounting, and if so, at inception, written premiums are fully earned and corresponding losses and loss expense recognized. The contracts can cause significant variances in gross premiums written, net premiums written, net premiums earned, and net incurred losses in the years in which they are written. Reinsurance contracts sold not meeting the established criteria for reinsurance accounting are recorded using the deposit method.

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(c) Premiums and Acquisition Costs (Continued)

Acquisition costs, which vary with and are directly related to the acquisition of policies, consist primarily of commissions paid to brokers and cedants, and are deferred and amortized over the period that the premiums are earned. Acquisition costs are shown net of commissions earned on reinsurance ceded. Future earned premiums, the anticipated losses and other costs (and in the case of a premium deficiency, investment income) related to those premiums, are also considered in determining the level of acquisition costs to be deferred.

(d) Reinsurance

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. Reinsurance premiums ceded are expensed (and any commissions recorded thereon are earned) on a monthly pro-rata basis over the period the reinsurance coverage is provided. Prepaid reinsurance premiums represent the portion of premiums ceded applicable to the unexpired term of policies in force. Mandatory reinstatement premiums ceded are recorded at the time a loss event occurs. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Provisions are made for estimated unrecoverable reinsurance.

Fee income and other includes fees received for insurance and product structuring services provided and is earned over the service period of the contract. Any adjustments to fees earned or the service period are reflected in income in the period when determined.

(e) Fee Income and Other

Fee income and other includes fees received for insurance and product structuring services provided and is earned over the service period of the contract. Any adjustments to fees earned or the service period are reflected in income in the period when determined.

(f) Other Than Temporary Impairments in Investments

The Company reviews the fair value of its investment portfolio on a periodic basis to identify declines in fair value below the carrying value that are other than temporary. This review involves consideration of several factors including (i) the time period during which there has been a significant decline in fair value below carrying value, (ii) an analysis of the liquidity, business prospects and overall financial condition of the issuer, (iii) the significance of the decline, (iv) an analysis of the collateral structure and other credit support, as applicable, of the securities in question, (v) expected future interest rate movements, and (vi) the Company s intent and ability to hold the investment for a sufficient period of time for the value to recover. Where the Company concludes that declines in fair values are other than temporary, the cost of the security is written down to fair value below carrying value and the previously unrealized loss is therefore realized in the period when such determination is made.

Hybrid or perpetual securities, which are classified as fixed maturities due to the existence of a call feature, are analyzed as debt securities for the purpose of evaluating other than temporary impairment.

With respect to securities where the decline in value is determined to be temporary and the security s value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of changing information. For further details on the factors considered in the evaluation other than temporary impairments see Note 9 Investments .

(g) Derivative Instruments

The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value. The changes in fair value of derivatives are shown in the consolidated statement of income as net realized and unrealized gains and losses on derivative instruments unless the

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(g) Derivative Instruments (Continued)

derivatives are designated as hedging instruments. The accounting for derivatives which are designated as hedging instruments is discussed below. Changes in fair value of derivatives may create volatility in the Company s results of operations from period to period. Amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) are offset against net fair value amounts recognized in the consolidated balance sheet for derivative instruments executed with the same counterparty under the same master netting arrangement.

Derivative contracts can be exchange-traded or OTC. Exchange-traded derivatives (futures and options) typically fall within Level 1 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources where an understanding of the inputs utilized in arriving at the valuations is obtained. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms and specific risks inherent in the instrument as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, interest rate swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. Such instruments comprise the majority of derivatives held by the Company and are typically classified within Level 2 of the fair value hierarchy.

Certain OTC derivatives trade in less liquid markets with limited pricing information, or required model inputs which are not directly market corroborated, which causes the determination of fair value for these derivatives to be inherently more subjective. Accordingly, such derivatives are classified within Level 3 of the fair value hierarchy. The valuations of less standard or liquid OTC derivatives are typically based on Level 1 and/or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Level 1 and Level 2 inputs are regularly updated to reflect observable market changes, with resulting gains and losses reflected within Level 3. Level 3 inputs are only changed when corroborated by evidence such as similar market transactions, pricing services and/or broker or dealer quotations.

The Company conducts its derivative activities in four main areas: investment related derivatives, credit derivatives, other non-investment related derivatives, and weather and energy derivatives.

Investment related derivatives

The Company s direct use of derivatives includes futures, forwards, swaps and option contracts that derive their value from underlying assets, indices, reference rates or a combination of these factors. The Company uses derivatives to manage duration, credit and foreign currency exposure for its investment portfolio as well as to add value to the investment portfolio through replicating permitted investments, provided the use of such investments is incorporated into the overall portfolio evaluation and complies with the Company s investment guidelines.

The Company uses derivative instruments, primarily interest rate swaps, to manage the interest rate exposure associated with certain assets and liabilities. All derivatives are recorded at fair value. On the date the derivative contract is entered into, the Company may designate the derivative as a hedge of the fair value of a recognized asset or liability (fair value hedge); a hedge of the variability in cash flows of a forecasted transaction or of amounts to be received or paid related to a recognized asset or liability (cash flow hedge); a hedge of a net investment in a foreign operation; or the Company may not designate any hedging relationship for a derivative contract.

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(g) Derivative Instruments (Continued)

Credit derivatives

Credit derivatives are recorded at fair value, which is determined using either models developed by the Company or third party prices and are dependent upon a number of factors, including changes in interest rates, future default rates, credit spreads, changes in credit quality, future expected recovery rates and other market factors. The change resulting from movements in credit and credit quality spreads is unrealized as the credit derivatives are not traded to realize this resultant value.

Other Non-Investment Related Derivatives

The Company may also enter into derivatives as part of contingent capital facilities including put options, interest rate swaps, and asset return swaps or hold contracts containing embedded derivatives such as life reinsurance contracts containing guaranteed minimum income benefits (GMIB) over the account balance upon the policyholder s election to take the income benefit. The fair value of this derivative is determined based on the present value of expected cash flows. In addition, the Company has modified coinsurance and funds withheld reinsurance agreements that provide for a return based on a portfolio of fixed income securities; as such, the agreements contain embedded derivatives. The embedded derivative is bifurcated from the funds withheld balance and recorded at fair value with changes in fair value recognized in earnings through net realized and unrealized gains and losses on derivative instruments.

Weather and Energy derivatives

Fair values for the Company s remaining natural gas contracts are determined through the use of quoted market prices. As quoted market prices are not widely available in the weather and electricity derivative markets, management uses available market data and internal pricing models based upon consistent statistical methodologies to estimate fair values. Estimating the fair value of instruments which do not have quoted market prices requires management s judgment in determining amounts which could reasonably be expected to be received from, or paid to, a third party in settlement of the contracts. The amounts could be materially different from the amounts that might be realized in an actual sale transaction. Fair values are subject to change in the near-term and reflect management s best estimate based on various factors including, but not limited to, actual and forecasted weather conditions, changes in commodity prices, changes in interest rates and other market factors.

Fair Value Hedges

Changes in the fair value of a derivative that is designated and qualifies as a fair value hedge, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings (through net realized and unrealized gains and losses on derivative instruments) with any differences between the net change in fair value of the derivative and the hedged item representing the hedge ineffectiveness. Periodic derivative net coupon settlements are recorded in net investment income with the exception of hedges of Company issued debt which are recorded in interest expense.

Cash Flow Hedges

Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in accumulated other comprehensive income (AOCI) and are reclassified into earnings when the variability of the cash flow of the hedged item impacts earnings. Gains and losses on derivative contracts that are reclassified from AOCI to current period earnings are included in the line item in the consolidated statements of operations in which the cash flows of the hedged item are recorded. Any hedge ineffectiveness is recorded immediately in current period earnings as net realized and unrealized gains and losses on derivative instruments. Periodic derivative net coupon settlements are recorded in net investment income.

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(g) Derivative Instruments (Continued)

Net Investment in a Foreign Operation Hedges

Changes in fair value of a derivative used as a hedge of a net investment in a foreign operation, to the extent effective as a hedge, are recorded in the foreign currency translation adjustments account within AOCI. Cumulative changes in fair value recorded in AOCI are reclassified into earnings upon the sale or complete or substantially complete liquidation of the foreign entity. Any hedge ineffectiveness is recorded immediately in current period earnings as net realized and unrealized gains and losses on derivative instruments. Periodic derivative net coupon settlements are recorded in net investment income. There were hedges of net investment in a foreign operation in place at December 31, 2006.

Hedge Documentation and Effectiveness Testing

To qualify for hedge accounting treatment, a derivative must be highly effective in mitigating the designated changes in value or cash flow of the hedged item. At hedge inception, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking each hedge transaction. The documentation process includes linking derivatives that are designated as fair value, cash flow, or net investment hedges to specific assets or liabilities on the balance sheet or to specific forecasted transactions. The Company also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. In addition, certain hedging relationships are considered highly effective if the changes in the fair value or discounted cash flows of the hedging instrument are within a ratio of 80-125% of the inverse changes in the fair value or discounted cash flows of the hedged item. Hedge ineffectiveness is measured using qualitative and quantitative methods. Qualitative methods may include comparison of critical terms of the derivative to the hedged item. Depending on the hedging strategy, quantitative methods may include the Change in Variable Cash Flows Method, the Change in Fair Value Method, the Hypothetical Derivative Method and the Dollar Offset Method.

Discontinuance of Hedge Accounting

The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item; the derivative is dedesignated as a hedging instrument; or the derivative expires or is sold, terminated or exercised. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, the derivative continues to be carried at fair value on the balance sheet with changes in its fair value recognized in current period earnings through net realized and unrealized gains and losses on derivative instruments. When hedge accounting is discontinued because the Company becomes aware that it is not probable that the forecasted transaction will occur, the derivative continues to be carried on the balance sheet at its fair value, and gains and losses that were accumulated in AOCI are recognized immediately in earnings.

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

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(h) Total Investments

Investments Available For Sale

Investments that are considered available for sale (comprised of the Company s fixed maturities, equity securities and short-term investments) are carried at fair value. The fair values for available for sale investments are generally sourced from third parties. The fair value of fixed maturity 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 or underwriter bid indications where pricing services do not provide coverage for a particular security. To the extent the Company believes current trading conditions represent distressed transactions, the Company may elect to utilize internally generated models. The pricing services use market approaches to valuations using primarily Level 2 inputs in the vast majority of valuations, or some form of discounted cash flow analysis to obtain investment values for a small percentage of fixed maturity securities for which they provide a price. Pricing services indicate that they will only produce an estimate of fair value if there is objectively verifiable information available to produce a valuation. Standard inputs to the valuations provided by the pricing services listed in approximate order of priority for use when available include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. The pricing services may prioritize inputs differently on any given day for any security, and not all inputs listed are available for use in the evaluation process on any given day for each security evaluation; however, the pricing services also monitor market indicators, industry and economic events. Information of this nature is a trigger to acquire further corroborating market data. When these inputs are not available, they identify buckets of similar securities (allocated by asset class types, sectors, sub-sectors, contractual cash flows/structure, and credit rating characteristics) and apply some form of matrix or other modeled pricing to determine an appropriate security value which represents their best estimate as to what a buyer in the marketplace would pay for a security in a current sale. While the Company receives values for the majority of the investment securities it holds from one or more 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. It is common industry practice to utilize pricing services as a source for determining the fair values of investments where the pricing services are able to obtain sufficient market corroborating information to allow them to produce a valuation at a reporting date. In addition, in the majority of cases although a value may be obtained from a particular pricing service for a security or class of similar securities, these values are corroborated against values provided by other pricing sources.

Broker quotations are used to value fixed maturities where prices are unavailable from pricing services due to factors specific to the security such as limited liquidity, lack of current transactions, or trades only taking place in privately negotiated transactions. These are considered Level 3 valuations as significant inputs utilized by brokers may be difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not obtained to support a Level 2 classification.

Prices provided by independent pricing services and independent broker quotes can vary widely even for the same security. The use of different methodologies and assumptions may have a material effect on the estimated fair value amounts. During periods of market disruption including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, such as the market disruption experienced during the year ended December 31, 2008, it may be difficult to value certain of the Company s securities, for example, CLOs, Alt-A and sub-prime mortgage backed securities, if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment. In such cases, more securities may fall to Level 3 and thus require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation as well as valuation methods which are more sophisticated or require greater

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(h) Total Investments (Continued)

estimation thereby resulting in values which may be different than the value at which the investments may be ultimately sold.

The net unrealized gain or loss on investments, net of tax, is included in accumulated other comprehensive income (loss). Any unrealized depreciation in value considered by management to be other than temporary is charged to income in the period in which that determination is made.

Short-term investments comprise investments with a remaining maturity of less than one year and are valued using the same external factors and in the same manner as fixed maturity securities.

Equity securities include investments in open end mutual funds and shares of publicly traded alternative funds. The fair value of equity securities is based upon quoted market values (Level 1), or monthly net asset value statements provided by the investment managers upon which subscriptions and redemptions can be executed (Level 2).

All investment transactions are recorded on a trade date basis. Realized gains and losses on sales of equities and fixed income investments are determined on the basis of average cost and amortized cost, respectively. Investment income is recognized when earned and includes interest and dividend income together with the amortization of premium and discount on fixed maturities and short-term investments. Amortization of discounts on fixed maturities includes amortization to expected recovery values for investments which have previously been recorded as other than temporarily impaired. For mortgage-backed securities, and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Prepayment fees or call premiums that are only payable to the Company when a security is called prior to its maturity, are earned when received and reflected in net investment income.

Investment In Affiliates

Investments in which the Company has significant influence over the operating and financial policies of the investee are classified as investments in affiliates on the Company s balance sheet and are accounted for under the equity method of accounting. Under this method, the Company records its proportionate share of income or loss from such investments in its results for the period as well as its portion of movements in certain of the investee shareholders equity balances. When financial statements of the affiliate are not available on a timely basis to record the Company s share of income or loss for the same reporting periods as the Company, the most recently available financial statements are used. This lag in reporting is applied consistently until timely information becomes available. Significant influence is generally deemed to exist where the Company has an investment of 20% or more in the common stock of a corporation or an investment of 3% or greater in closed end funds, limited partnerships, LLCs or similar investment vehicles. The Company records its alternative and private fund affiliates on a one month and three month lag, respectively, and its operating affiliates on a three month lag. Significant influence is considered for other strategic investments on a case- by-case basis. Investments in affiliates are not subject to FAS 157 as they are not considered to be fair value measurements under FAS 157. However, impairments associated with investments in affiliates that are deemed to be other-than-temporary are calculated in accordance with FAS 157 and appropriate disclosures included within the financial statements during the period the losses are recorded.

Other investments

Contained within this asset class are investments including direct equity investments, investment funds, limited partnerships, unrated tranches of collateralized debt obligations and certain structured project finance transactions. The Company accounts for its other investments that do not have readily determinable market values at estimated fair value as it has no significant influence (as defined above) over these entities.

XL CAPITAL LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(h) Total Investments (Continued)

Fair values for other investments, principally other direct equity investments, investment funds and limited partnerships, are primarily based on the net asset value provided by the investment manager, the general partner or the respective entity, recent financial information, available market data and, in certain cases, management judgment may be required. These entities generally carry their trading positions and investments, the majority of which have underlying securities valued using Level 1 or Level 2 inputs, at fair value as determined by their respective investment managers; accordingly, these investments are generally classified as Level 2. Private equity investments are classified as Level 3. The net unrealized gain or loss on investments, net of tax, is included in Accumulated other comprehensive income (loss). Any unrealized loss in value considered by management to be other than temporary is charged to income in the period that it is determined.

Income on unrated tranches of collateralized debt obligations is reflected only to the extent the Company s principal has been fully recovered. This is not considered to be a fair value measurement under FAS 157 and accordingly these investments have been excluded from FAS 157 disclosures. These investments are carried under the cost recovery method given the uncertainty of future cash flows. The carrying value of these investments held by the Company at December 31, 2008 and December 31, 2007 was $14.7 million and $22.7 million, respectively.

In addition, the Company historically participated in structured transactions in project finance related areas under which the Company provides a cash loan supporting a trade finance transaction. These transactions are accounted for in accordance with SOP 01-6, Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others under which the loans are considered held for investment as the Company has the intent and ability to hold for the foreseeable future or until maturity or payoff. Accordingly, these funded loan participations are reported in the balance sheet at outstanding principal adjusted for any allowance for loan losses as considered necessary by management. These investments are not considered to be fair value measurements under FAS 157 and accordingly they have been excluded from the FAS 157 disclosures. The carrying value of these investments held by the Company at December 31, 2008 and December 31, 2007 was $80.1 million and $125.1 million, respectively.

Securities lending

The Company engages in a securities lending program whereby certain securities from the Company s portfolio are loaned to other institutions for short periods of time. The market value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the market value of the loaned securities changes. The Company s policy is to require fixed maturities and initial cash collateral equal to between 102% and 105% of the fair value of the loaned securities depending on the class of assets loaned. The Company continues to earn interest on the securities loaned. In addition, the Company shares a portion of the interest earned on the collateral with the lending agent. The proceeds from securities lending collateral is invested and included in cash and cash equivalents or investments available for sale with a corresponding liability related to the Company s obligation to return the collateral plus interest included in net payable for investments purchased. During 2008, the Company capped its maximum participation in the securities lending program at $300 million and is in the process of unwinding its participation.

(i) Cash Equivalents

Cash equivalents include fixed interest deposits placed with a maturity of under 90 days when purchased. Bank deposits are not considered to be fair value measurements and as such are not subject to FAS 157 disclosures. Money market funds are classified as Level 1 as these instruments are considered actively traded; however, certificates of deposit are classified as Level 2.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

2. Significant Accounting Policies (Continued)

(j) Foreign Currency Translation

Assets and liabilities of foreign operations whose functional currency is not the U.S. dollar are translated at prevailing year end exchange rates. Revenue and expenses of such foreign operations are translated at average exchange rates during the year. The net effect of the translation adjustments for foreign operations, net of applicable deferred income taxes, as well as any gains or losses on intercompany balances for which settlement is not planned or anticipated in the foreseeable future, are included in accumulated other