

**XL Insurance (Bermuda) Ltd**  
**Consolidated Financial Statements**  
**For The Years Ended**  
December 31, 2013 and 2012



**April 30, 2014**

**Independent Auditor's Report**

**To the Shareholder of  
XL Insurance (Bermuda) Ltd**

We have audited the accompanying consolidated financial statements of XL Insurance (Bermuda) Ltd and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and December 31, 2012, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended.

**Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of XL Insurance (Bermuda) Ltd and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Pricewaterhouse Coopers Ltd.

**Chartered Accountants**

**XL Insurance (Bermuda) Ltd**  
**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 2013 AND 2012**

(U.S. dollars in thousands, except share data)

	<u>2013</u>	<u>2012</u>
<b>ASSETS</b>		
Investments:		
Fixed maturities, at fair value (amortized cost: 2013: \$25,698,927; 2012: \$25,429,463).....	\$ 26,054,730	\$ 26,660,524
Equity securities, at fair value (cost: 2013: \$903,201; 2012: \$617,486).....	1,040,237	649,359
Short-term investments, at fair value (amortized cost: 2013: \$356,595; 2012: \$322,561).....	357,455	322,703
Total investments available for sale .....	\$ 27,452,422	\$ 27,632,586
Fixed maturities, held to maturity at amortized cost (fair value: 2013: \$3,131,235; 2012: \$3,262,804) .....	2,858,695	2,814,447
Investments in affiliates .....	1,370,943	1,126,875
Other investments.....	1,160,033	1,212,102
Total investments.....	\$ 32,842,093	\$ 32,786,010
Cash and cash equivalents .....	1,751,309	2,388,342
Accrued investment income.....	338,358	334,071
Deferred acquisition costs.....	670,659	675,705
Ceded unearned premiums.....	788,871	587,909
Premiums receivable .....	2,612,602	2,568,861
Reinsurance balances receivable.....	118,885	58,428
Unpaid losses and loss expenses recoverable .....	3,435,230	3,382,101
Net receivable from investments sold .....	144,765	16,002
Amount due from Parent and affiliates .....	4,467	1,200
Goodwill and other intangible assets .....	275,577	272,494
Deferred tax asset.....	237,884	162,188
Other assets .....	554,782	461,320
<b>Total assets .....</b>	<b>\$ 43,775,482</b>	<b>\$ 43,694,631</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Unpaid losses and loss expenses .....	\$ 20,481,065	\$ 20,484,121
Deposit liabilities .....	1,509,243	1,551,398
Future policy benefit reserves .....	4,803,816	4,812,045
Unearned premiums .....	3,846,526	3,755,920
Reinsurance balances payable.....	302,399	143,112
Net Payable for investments purchased.....	60,162	102,112
Deferred tax liability .....	86,330	141,803
Amount due to affiliates.....	61,347	44,953
Other liabilities.....	874,935	799,984
<b>Total liabilities .....</b>	<b>\$ 32,025,823</b>	<b>\$ 31,835,448</b>
Commitments and Contingencies		
Shareholders' Equity:		
Ordinary shares, 15,000,000 authorized, par value \$0.10; issued and outstanding: (2013: 10,000,000; 2012: 10,000,000) .....	\$ 1,000	\$ 1,000
Additional paid in capital.....	9,341,901	9,204,182
Accumulated other comprehensive income .....	531,551	1,275,116
Retained earnings (deficit) .....	1,868,029	1,377,060
Shareholders' equity attributable to XL Group plc.....	\$ 11,742,481	\$ 11,857,358
Non-controlling interest in equity of consolidated subsidiaries .....	7,178	1,825
<b>Total shareholders' equity .....</b>	<b>\$ 11,749,659</b>	<b>\$ 11,859,183</b>
<b>Total liabilities and shareholders' equity .....</b>	<b>\$ 43,775,482</b>	<b>\$ 43,694,631</b>

See accompanying Notes to Consolidated Financial Statements

**XL INSURANCE (BERMUDA) LTD**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

(U.S. dollars in thousands)

	<u>2013</u>	<u>2012</u>
<b>Revenues:</b>		
Net premiums earned .....	\$ 6,309,520	\$ 6,090,441
Net investment income .....	910,099	975,605
Realized investment gains (losses): .....		
Net realized gains (losses) on investments sold .....	77,486	146,931
Other-than-temporary impairments on investments .....	(7,344)	(34,004)
Other-than-temporary impairments on investments transferred to (from) other comprehensive income .....	(5,015)	(19,896)
Total net realized gains (losses) on investments .....	\$ 65,127	\$ 93,031
Net realized and unrealized gains (losses) on derivative instruments .....	7,797	5,246
Income (loss) from investment fund affiliates .....	138,388	58,485
Fee income and other .....	40,032	50,034
<b>Total revenues</b> .....	<u>\$ 7,470,963</u>	<u>\$ 7,272,842</u>
<b>Expenses:</b>		
Net losses and loss expenses incurred .....	\$ 3,731,464	\$ 3,765,482
Claims and policy benefits .....	465,702	486,198
Acquisition costs .....	909,324	913,492
Operating expenses .....	1,193,499	1,139,453
Exchange (gains) losses .....	(28,574)	10,383
Interest expense .....	57,450	83,239
<b>Total expenses</b> .....	<u>\$ 6,328,865</u>	<u>\$ 6,398,247</u>
Income (loss) before income tax and income (loss) from operating affiliates .....	\$ 1,142,098	\$ 874,595
Income (loss) from operating affiliates .....	119,804	55,810
Provision for income tax .....	(72,514)	(35,668)
<b>Net income (loss)</b> .....	<u>\$ 1,189,388</u>	<u>\$ 894,737</u>
Non-controlling interests .....	500	(167)
<b>Net income (loss) attributable to XL Insurance (Bermuda) Ltd</b> .....	<u>\$ 1,189,888</u>	<u>\$ 894,570</u>

See accompanying Notes to Consolidated Financial Statements

**XL INSURANCE (BERMUDA) LTD**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

*(U.S. dollars in thousands)*

	<u>2013</u>	<u>2012</u>
<b>Net income (loss) attributable to XL Insurance (Bermuda) Ltd.....</b>	<b>\$ 1,189,888</b>	<b>\$ 894,570</b>
Change in net unrealized gains (losses) on investments, net of tax .....	(756,369)	715,196
Change in net unrealized gains (losses) on affiliate and other investments, net of tax .....	29,702	45,985
Change in OTTI losses recognized in other comprehensive income, net of tax .....	28,246	51,702
Change in underfunded pension liability .....	11,162	(9,986)
Foreign currency translation adjustments .....	(56,306)	7,227
<b>Comprehensive income (loss).....</b>	<b><u>\$ 446,323</u></b>	<b><u>\$ 1,704,694</u></b>

See accompanying Notes to Consolidated Financial Statements

**XL INSURANCE (BERMUDA) Ltd**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

(U.S. dollars in thousands)

	2013	2012
<b>Ordinary Shares:</b>		
Balance - beginning of year .....	\$ 1,000	\$ 1,000
<b>Balance - end of year .....</b>	<b>\$ 1,000</b>	<b>\$ 1,000</b>
<b>Additional Paid in Capital:</b>		
Balance - beginning of year .....	\$ 9,204,182	\$ 8,995,334
Receipt of Capital .....	137,719	208,848
<b>Balance - end of year .....</b>	<b>\$ 9,341,901</b>	<b>\$ 9,204,182</b>
<b>Accumulated Other Comprehensive Income (Loss):</b>		
Balance - beginning of year .....	\$ 1,275,116	\$ 464,992
Change in net unrealized gains (losses) on investments, net of tax .....	(756,369)	715,196
Change in net unrealized gains (losses) on affiliate and other investments, net of tax .....	29,702	45,985
Change in OTTI losses recognized in other comprehensive income, net of tax ....	28,246	51,702
Change in underfunded pension liability .....	11,162	(9,986)
Foreign currency translation adjustments .....	(56,306)	7,227
<b>Balance - end of year .....</b>	<b>\$ 531,551</b>	<b>\$ 1,275,116</b>
<b>Retained Earnings (Deficit):</b>		
Balance - beginning of year .....	\$ 1,377,060	\$ 1,089,801
Net income attributable to XL Insurance (Bermuda) Ltd .....	1,189,888	894,570
Dividends on ordinary shares .....	(698,919)	(607,311)
<b>Balance - end of year .....</b>	<b>\$ 1,868,029</b>	<b>\$ 1,377,060</b>
<b>Non-controlling Interest in Equity of Consolidated Subsidiaries:</b>		
Balance - beginning of year .....	\$ 1,825	\$ -
Non-controlling interests .....	5,353	1,825
<b>Balance - end of year .....</b>	<b>\$ 7,178</b>	<b>\$ 1,825</b>
<b>Total Shareholders' Equity .....</b>	<b>\$ 11,749,659</b>	<b>\$ 11,859,183</b>

See accompanying Notes to Consolidated Financial Statements

**XL INSURANCE (BERMUDA) Ltd**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

(U.S. dollars in thousands)

	<u>2013</u>	<u>2012</u>
<b>Cash flows provided by (used in) operating activities:</b>		
Net income (loss) .....	\$ 1,189,388	\$ 894,737
<b>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:</b>		
Net realized (gains) losses on investments .....	(65,127)	(93,031)
Net realized and unrealized (gains) losses on derivative instruments .....	(7,797)	(5,246)
Amortization of premiums (discounts) on fixed maturities .....	167,846	170,826
(Income) loss from investment and operating affiliates .....	(229,383)	(114,296)
Depreciation .....	49,884	51,794
Accretion of deposit liabilities .....	47,256	81,269
<b>Changes in:</b>		
Unpaid losses and loss expenses .....	(88,636)	(287,972)
Future policy benefit reserves .....	(164,923)	(187,400)
Unearned premiums .....	65,279	182,963
Premiums receivable .....	(27,334)	(127,633)
Unpaid losses and loss expenses recoverable .....	(36,897)	305,675
Amounts due from parent and affiliates .....	13,311	470,953
Ceded unearned premiums .....	(196,674)	14,923
Reinsurance balances receivable .....	(60,317)	162,280
Deferred acquisition costs .....	8,532	(649)
Reinsurance balances payable .....	161,132	48,159
Deferred tax asset - net .....	(29,230)	(28,556)
Derivatives .....	(22,324)	7,252
Other assets .....	(17,111)	32,975
Other liabilities .....	67,750	51,720
Other .....	16,185	(57,475)
<b>Total adjustments .....</b>	<u>\$ (348,578)</u>	<u>\$ 678,531</u>
<b>Net cash provided by (used in) operating activities .....</b>	<u>\$ 840,810</u>	<u>\$ 1,573,268</u>
<b>Cash flows provided by (used in) investing activities:</b>		
Proceeds from sale of fixed maturities and short-term investments .....	\$ 4,089,469	\$ 1,912,201
Proceeds from redemption of fixed maturities and short-term investments .....	3,805,279	4,243,346
Proceeds from sale of equity securities .....	245,538	221,617
Purchases of fixed maturities and short-term investments .....	(8,285,658)	(7,363,361)
Purchases of equity securities .....	(534,356)	(362,021)
Proceeds from sale of affiliates .....	190,954	133,375
Purchases of affiliates .....	(353,678)	(138,027)
Other, net .....	53,810	(79,358)
<b>Net cash provided by (used in) investing activities .....</b>	<u>\$ (788,642)</u>	<u>\$ (1,432,228)</u>

See accompanying Notes to Consolidated Financial Statements



**XL INSURANCE (BERMUDA) Ltd**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
<b>Cash flows provided by (used in) financing activities:</b>		
Dividends paid on ordinary shares .....	(609,465)	(232,608)
Contribution from non-controlling interest .....	7,747	1,500
Contribution from Parent Company .....	11,721	208,848
Repayment of loan to Parent Company .....	-	(100,000)
Repayment of debt .....	-	(600,000)
Deposit liabilities .....	(94,386)	(134,950)
<b>Net cash provided by (used in) financing activities .....</b>	<b>\$ (684,383)</b>	<b>\$ (857,210)</b>
Effects of exchange rate changes on foreign currency cash .....	(4,818)	24,493
Increase (decrease) in cash and cash equivalents .....	<b>\$ (637,033)</b>	<b>\$ (691,677)</b>
<b>Cash and cash equivalents - beginning of period .....</b>	<b>2,388,342</b>	<b>3,080,019</b>
<b>Cash and cash equivalents - end of period .....</b>	<b>\$ 1,751,309</b>	<b>\$ 2,388,342</b>
Net taxes paid .....	<b>\$ 96,098</b>	<b>\$ 34,094</b>
Interest paid on notes payable and debt .....	<b>\$ -</b>	<b>\$ 19,500</b>

See accompanying Notes to Consolidated Financial Statements

**XL INSURANCE (BERMUDA) LTD**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

**1. General**

XL Insurance (Bermuda) Ltd (the “Company” or “XL”) is an insurance company formed in 1986 under the laws of Bermuda and is registered as a Class 4 insurer. The Company’s ultimate parent is XL Group plc, an Irish public limited company.

The Company is a leading provider of insurance and reinsurance coverages to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. The Company and its various subsidiaries operate globally in 24 countries, through its three business segments: Insurance, Reinsurance and Life operations.

**Insurance Operations**

The Company’s insurance operations are organized into four business units: International Property and Casualty (“IPC”), North America Property and Casualty (“NAPC”), Global Professional (“Professional”) and Global Specialty (“Specialty”). IPC includes property, primary and excess casualty and environmental liability. NAPC includes property, primary and excess casualty, environmental liability, excess and surplus lines, construction, surety and program business. Global Professional includes directors’ and officers’ liability, errors and omissions liability and employment practices liability and technology and cyber liability coverages. Global Specialty includes aviation and satellite, marine and offshore energy, fine art and specie, equine, product recall, political risk and trade credit and North America inland marine. In 2013, the company began offering insurance to protect assets that are exposed to war, terrorism and political violence attacks, as well as kidnap and ransom coverages.

Also included as part of the Insurance segment is XL Global Asset Protection Services (“XL GAPS”), a fee for service loss prevention consulting service that offers individually tailored risk management solutions to risk managers, insurance brokers and insurance company clients operating on a global basis. Services are offered on an “unbundled” (services not tied to an insurance contract) and “bundled” basis.

**Reinsurance Operations**

The Company's reinsurance operations are structured geographically into business operations: Bermuda, North American, European/Asia Pacific and Latin American. During the second quarter of 2013, the business groups were realigned to include Latin America with the International business group. The segment provides casualty, property risk, property catastrophe, marine, aviation, treaty and other specialty reinsurance on a global basis.

**Life Operations**

During 2009, the Company completed a strategic review of its life reinsurance business. In relation to this initiative, during 2009 the Company sold the renewal rights to certain of its businesses, sold its U.S. Life businesses and announced that it would run-off its existing book of life and annuity business, and not accept new business. In addition, in 2010, the Company consummated various transactions to novate and recapture U.K. and Irish term assurance and critical illness treaties and U.S. mortality retrocession pools. In addition, during the fourth quarter of 2012, the Company entered into an agreement to recapture two small U.S. life reinsurance treaties.

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.

**XL INSURANCE (BERMUDA) LTD**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

**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”). To facilitate period-to-period comparisons, certain reclassifications have been made to prior year consolidated financial statement amounts to conform to current year presentation. There was no effect on net income from this change in 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;
- valuation and other-than-temporary impairments 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***

Accounting guidance over fair value measurements 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. 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.

***Basis of Fair Value Measurement***

Fair value measurements accounting guidance 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 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 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 are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

**XL INSURANCE (BERMUDA) LTD**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

**2. Significant Accounting Policies**

- **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 authoritative guidance on fair value measurements to illustrate the bases for determining the fair values of these items held by the Company are included 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, or estimates of fair values provided by independent pricing services and brokers. Fair values of financial instruments for which quoted market prices are not available or for which the company believes current trading conditions represent distressed markets are based on estimates using present value or other valuation techniques. The fair values estimated using such 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.

**(c) 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 values of fixed income securities are 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 income 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, customer feedback through a price challenge process and 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 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 services.

Broker/dealer 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 available to support a Level 2 classification.

**XL INSURANCE (BERMUDA) LTD**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

**2. Significant Accounting Policies**

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.

The net unrealized gain or loss on investments, net of tax, is included in “accumulated other comprehensive income (loss).”

Short-term investments include investments due to mature within one year from the date of purchase and are valued using the same external factors and in the same manner as fixed income 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 a first-in, first-out basis. 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, and is recorded net of related investment expenses. Amortization of discounts on fixed maturities includes amortization to expected recovery values for investments that 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.

***Investments Held to Maturity***

Investments classified as held to maturity include securities for which the Company has the ability and intent to hold to maturity and are carried at amortized cost. For details see Note 5, “Investments.”

***Investments 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. Distributions received from affiliates representing returns on invested capital are recorded as operating cash flows, while distributions representing returns of invested capital or proceeds upon sale of all or a portion of an affiliate are recorded as investing cash flows.

The Company generally records its alternative and private equity fund affiliates on a one-month and three-month lag, respectively, and its operating affiliates on a three-month lag. 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 more in closed end funds, limited partnerships, LLCs or similar investment vehicles. Significant influence is considered for other strategic investments on a case-by-case basis. Investments in affiliates are not subject to fair value measurement guidance as they are not considered to be fair value measured investments under U.S. GAAP. However, impairments associated with investments in affiliates that are deemed to be other-than-temporary are calculated in accordance with fair value measurement guidance and appropriate disclosures included within the financial statements during the period the losses are recorded.

**XL INSURANCE (BERMUDA) LTD**  
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*Other Investments*

Contained within this asset class are equity interests in investment funds, limited partnerships and unrated tranches of collateralized debt obligations for which the Company does not have sufficient rights or ownership interests to follow the equity method of accounting. The Company accounts for equity securities that do not have readily determinable market values at estimated fair value as it has no significant influence over these entities. Also included within other investments are structured transactions which are carried at amortized cost.

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.

Overseas deposits include investments in private funds related to Lloyd's syndicates in which the underlying instruments are primarily cash equivalents. The funds themselves do not trade on an exchange and therefore are not included within available for sale securities. Also included in overseas deposits are restricted cash and cash equivalent balances held by Lloyd's syndicates for solvency purposes. Given the restricted nature of these cash balances, they are not included within the cash and cash equivalents line in the balance sheet. Each of these investment types is considered a Level 2 valuation.

The Company historically participated in structured transactions that include cash loans supporting project finance transactions, providing liquidity facility financing to a structured project deal in 2009 and the Company also invested in a payment obligation with an insurance company. These transactions are carried at amortized cost. For further details see Note 3, "Fair Value Measurements," and Note 6, "Other Investments."

**(d) 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.

Premiums are earned on a pro-rata basis over the period the coverage is provided. 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 has periodically written 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.

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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.

**(e) 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. Ceded unearned 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.

**(f) 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.

**(g) Other-Than-Temporary Impairments (“OTTI”) of Available for Sale and Held to Maturity Securities**

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) an analysis of the liquidity, business prospects and financial condition of the issuer including consideration of credit ratings, (ii) the significance of the decline, (iii) an analysis of the collateral structure and other credit support, as applicable, of the securities in question, and (iv) for debt securities, whether the Company intends to sell such securities. In addition, the authoritative guidance requires that OTTI for certain asset backed and mortgage backed securities is recognized if the fair value of the security is less than its discounted cash flow value 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 discounted cash flow and a portion of the previously unrealized loss is therefore realized in the period such determination is made.

If the Company intends to sell an impaired debt security, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, the impairment is other-than-temporary and is recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost.

In instances in which the Company determines that a credit loss exists but the Company does not intend to sell the security, and it is not more likely than not that the Company will be required to sell the security before the anticipated recovery of its remaining amortized cost basis, the OTTI is separated into (1) the amount of the total impairment related to the credit loss and (2) the amount of the total impairment related to all other factors (i.e. the noncredit portion). The amount of the total OTTI related to the credit loss is recognized in earnings and the amount of the total OTTI related to all other factors is recognized in accumulated other comprehensive loss. The total OTTI is presented in the income statement with an offset for the amount of the total OTTI that is recognized in accumulated other comprehensive loss. Absent the intent or requirement to sell a security, if a credit loss does not exist, any impairment is considered to be temporary.

The noncredit portion of any OTTI losses on securities classified as available for sale is recorded as a component of other comprehensive income with an offsetting adjustment to the carrying value of the security. The fair value adjustment could increase or decrease the carrying value of the security. The noncredit portion of any OTTI losses recognized in accumulated other comprehensive loss for debt securities classified as held to maturity would be accreted over the remaining life of the debt security (in a pro rata manner based on the amount of actual cash flows received as a percentage of total estimated cash flows) as an increase in the carrying value of the security until the security is sold, the security matures, or there is an additional OTTI that is recognized in earnings.

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In periods subsequent to the recognition of an OTTI loss, the other-than-temporarily impaired debt security is accounted for as if it had been purchased on the measurement date of the OTTI at an amount equal to the previous amortized cost basis less the credit-related OTTI recognized in earnings. For debt securities for which credit-related OTTI is recognized in earnings, the difference between the new cost basis and the cash flows expected to be collected is accreted into interest income over the remaining life of the security in a prospective manner based on the estimated amount and timing of future estimated cash flows.

With respect to securities where the decline in value is determined to be temporary and the security's amortized cost 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 manager service providers. While these investment manager service providers 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.

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. For further details on the factors considered in evaluation of OTTI see Note 4, "Investments."

**(h) 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 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 netting arrangement to the extent that the Company intends to settle the amounts on a net basis.

Derivative contracts can be exchange-traded or over-the-counter ("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.



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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. 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 non-hedging derivatives activities in three main areas: investment related derivatives, credit derivatives and other non-investment related derivatives.

The Company uses derivative instruments, primarily interest rate swaps, to manage the interest rate exposure associated with certain assets and liabilities. These 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); or a hedge of a net investment in a foreign operation; or the Company may not designate any hedging relationship for a derivative contract.

***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. The Company may designate fair value hedging relationships where interest rate swaps are used to hedge the changes in fair value of certain fixed rate liabilities and fixed maturity securities due to changes in the designated benchmark interest rate.

***Hedges of the Net Investment in a Foreign Operation***

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.”

***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” or the “Dollar Offset Method.”

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**2. Significant Accounting Policies**

*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.

**(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 the authoritative guidance on fair value measurement 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.

**(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 comprehensive income (loss).”

Monetary assets and liabilities denominated in currencies other than the functional currency of the applicable entity are revalued at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the exchange rate on the date the transaction occurs with the resulting foreign exchange gains and losses on settlement or revaluation recognized in income.

**(k) 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 accounting guidance for goodwill and other intangible assets, the Company tests goodwill for potential impairment annually as of June 30, during the third quarter, 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. For further details on the factors considered in the goodwill impairment evaluation see Note 7, “Goodwill and Other Intangible Assets.”

The Company’s indefinite lived intangible assets consist primarily of acquired insurance and reinsurance licenses. These assets are deemed to have indefinite useful lives and are therefore not subject to amortization. In accordance with the authoritative guidance on intangibles and goodwill and other assets under GAAP, all of the Company’s non-amortized intangible assets are subject to a test for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Pursuant to the authoritative guidance, if the carrying value of a non-amortized intangible asset is in excess of its fair value, the asset must be written down to its fair value through the recognition of an impairment charge to earnings.

All of the Company’s amortizable or depreciable long-lived assets such as premises, equipment, and acquired or internally-developed software are carried at net book value and are amortized or depreciated on a straight-line basis over their estimated useful lives. The amortization periods approximate the period over which the Company expects to generate future net cash flows from the use of the assets. All of these assets are subject to impairment testing in accordance with authoritative guidance for the impairment or disposal of long-lived assets when events or conditions indicate that the carrying value of an asset may not be fully recoverable from future cash flows.

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**(l) Variable Interest Entities (“VIE’s”)**

Investments in other interests that absorb portions of an entity’s expected losses or receive portions of the entity’s expected residual returns are called variable interests. Entities in which the equity investors, as a group, do not have characteristic of a controlling financial interest, or that do not have sufficient equity at risk to allow them to finance their own activities without additional financial support are referred to as VIEs.

A VIE must be consolidated by its primary beneficiary, which is the variable interest holder that is determined to have the controlling financial interest in the entity. Based upon the nature of the VIE, this is either the entity that has both: a) the power to direct the VIE’s activities that most significantly impact its economic performance, and b) the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to it; or it is the reporting entity that will absorb a majority of the VIE’s expected losses, receive a majority of the VIE’s expected residual returns, or both.

Refer to Note 14, “Variable Interest Entities” for further discussion of the Company’s interest in VIE’s.

**(m) Non-Controlling Interests**

Non-controlling shareholders’ interests are presented separately in the Company’s Consolidated Balance Sheets and Consolidated Statements of Shareholders’ Equity are required under GAAP. The net loss (income) attributable to non-controlling interests is presented separately in the Company’s Consolidated Statements of Comprehensive Income. Refer to Note 14, “Variable Interest Entities”.

**(n) Losses and Loss Expenses**

Unpaid losses and loss expenses include reserves for reported unpaid losses and loss expenses and for losses incurred but not reported. The reserve for reported unpaid losses and loss expenses for the Company’s property and casualty operations is established by management based on claims reported from insureds or amounts reported from ceding companies, and represent the estimated ultimate cost of events or conditions that have been reported to or specifically identified by the Company.

The reserve for losses incurred but not reported is estimated by management based on loss development patterns determined by reference to the Company’s underwriting practices, the policy form, type of program and historical experience. The Company’s actuaries employ a variety of generally accepted methodologies to determine estimated ultimate loss reserves, including the “Bornhuetter-Ferguson incurred loss method” and frequency and severity approaches.

Certain workers’ compensation and certain U.K. motor liability claims liabilities are considered fixed and determinable and are discounted.

Management believes that the reserves for unpaid losses and loss expenses are sufficient to cover losses that fall within coverages assumed by the Company. However, there can be no assurance that losses will not exceed the Company’s total reserves. The methodology of estimating loss reserves is periodically reviewed to ensure that the assumptions made continue to be appropriate and any adjustments resulting from such reviews are reflected in income in the year in which the adjustments are made.

**(o) Deposit Liabilities**

Contracts entered into by the Company that are not deemed to transfer significant underwriting and/or timing risk are accounted for as deposits, whereby liabilities are initially recorded at an amount equal to the assets received. The Company uses a portfolio rate of return of equivalent duration to the liabilities in determining risk transfer. An initial accretion rate is established based on actuarial estimates whereby the deposit liability is increased to the estimated amount payable over the term of the contract.

The deposit accretion rate is the rate of return required to fund expected future payment obligations (this is equivalent to the “best estimate” of future cash flows), which are determined actuarially based upon the nature of the underlying indemnifiable losses. Accretion of the liability is recorded as interest expense.

The Company periodically reassesses the estimated ultimate liability. Any changes to this liability are reflected as adjustments to interest expense to reflect the cumulative effect of the period the contract has been in force, and by an adjustment to the future accretion rate of the liability over the remaining estimated contract term.

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**2. Significant Accounting Policies**

**(p) Future Policy Benefit Reserves**

The Company estimates the present value of future policy benefits related to long duration contracts using assumptions for investment yields, mortality, and expenses, including a provision for adverse deviation.

The assumptions used to determine future policy benefit reserves are best estimate assumptions that are determined at the inception of the contracts and are locked-in throughout the life of the contract unless a premium deficiency develops. As the experience on the contracts emerges, the assumptions are reviewed. If such review would produce reserves in excess of those currently held, then the lock-in assumptions will be revised and a claim and policy benefit is recognized at that time. The Company includes the cost of reinsurance in its premium deficiency considerations. For certain annuity contracts, policy benefit reserves may be increased for the impact of unrealized gains on investments supporting these contracts, as if these gains had been realized, with a corresponding charge to other comprehensive income ("shadow adjustments").

Certain life insurance and annuity contracts provide the holder with a guarantee that the benefit received upon death will be no less than a minimum prescribed amount. The contracts are accounted for in accordance with the authoritative guidance on Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Separate Accounts, which requires that the best estimate of future experience be combined with actual experience to determine the benefit ratio used to calculate the policy benefit reserve.

**(q) 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 deferral of tax losses is evaluated based upon management's estimates of the future profitability of the Company's taxable entities based on current forecasts and the period for which losses may be carried forward. A valuation allowance is established for any portion of a deferred tax asset that management believes will not be realized. The Company continues to evaluate income generated in future periods by its subsidiaries in different jurisdictions in determining the recoverability of its deferred tax asset. If it is determined that future income generated by these subsidiaries is insufficient to cause the realization of the net operating losses within a reasonable period, a valuation allowance is established at that time.

The Company recognizes the tax benefit from an uncertain tax position taken only if it is more likely than not that the tax position will be sustained upon examination by the relevant tax authority, based on our interpretation of and judgment over tax law. The Company reviews its uncertain tax positions on a quarterly basis. Tax positions that meet the more likely than not threshold are measured using a probability weighted approach, whereby the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement is recognized. The Company recognizes interest and penalties on underpaid tax in income tax expense.

**(r) Stock Plans**

At December 31, 2013, the Company had several stock-based performance incentive programs. Stock-based compensation issued under these plans generally has a life of not longer than ten years and vests as set forth at the time of grant. Awards currently vest annually over three or four years from the date of grant. The Company recognizes compensation costs for stock-based awards on a straight-line basis over the requisite service period (usually the vesting period) for each award.

Share-based payments to employees, including grants of employee stock options, are recognized in the financial statements over the vesting period based on their grant date fair values.

Authoritative guidance requires that compensation costs be recognized for unvested stock-based compensation awards over the period through the date that the employee is no longer required to provide future services to earn the award, rather than over the explicit service period. Accordingly, the Company follows a policy of recognizing compensation cost to coincide with the date that the employee is eligible to retire, rather than the actual retirement date, for all stock-based compensation granted.

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**2. Significant Accounting Policies**

**(s) Recent Accounting Pronouncements**

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

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

In June 2011, the FASB issued an accounting standards update concerning the presentation of comprehensive income in financial statements. This guidance allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income only as part of the statement of changes in shareholders' equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company adopted the guidance from January 1, 2012; however, it did not have an impact on the Company's disclosure, financial condition or results of operations or cash flows. In February 2013, the FASB issued an additional accounting standards update related to this topic that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The Company adopted this additional guidance prospectively from January 1, 2013. As this guidance is disclosure-related only and does not change the current requirements for reporting net income or other comprehensive income in financial statements, its adoption did not impact the Company's financial condition, results of operations, or cash flows.

In September 2011, the FASB issued an accounting standards update to simplify how entities test goodwill for impairment, by allowing an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting entity is less than its carrying amount, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test required under U.S. GAAP accounting rules. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of a reporting unit as compared to its carrying value meets the threshold, then performing the two-step impairment step is unnecessary. In other circumstances, performance of the two-step test is required. The guidance also eliminates the option for an entity to carry forward its detailed calculation of a reporting unit's fair value in certain situations. The Company adopted this guidance from January 1, 2012. It did not have an impact on the Company's consolidated financial condition, results of operations, or cash flows.

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**2. Significant Accounting Policies**

In December 2011, the FASB issued an accounting standards update requiring additional disclosures about financial instruments and derivatives that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. In January 2013, the FASB issued an additional accounting standards update related to this topic clarifying that the disclosures would apply only to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions, each to the extent that they met one of the two conditions provided in the initial accounting standard. This guidance was adopted from January 1, 2013, on a retrospective basis for all fiscal periods presented. As this guidance is disclosure-related only and does not amend the existing balance sheet offsetting guidance, its adoption did not impact the Company's financial condition, results of operations, or cash flows.

In July 2012, the FASB issued an accounting standards update to simplify how entities test indefinite-lived intangible assets for impairment. Under this new guidance, an entity is allowed the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of the intangible asset as compared to its carrying value meets the threshold, it may bypass the existing requirements to perform a full quantitative impairment test on the intangible asset, a test which otherwise would have to be performed annually, at a minimum. The guidance was effective during the fourth quarter of 2012. The Company adopted this guidance from January 1, 2013. It did not have an impact on the Company's consolidated financial condition, results of operations or cash flows.

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

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**3. Fair Value Measurements**

**(a) Fair Value Summary**

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at December 31, 2013 and December 31, 2012 by level within the fair value hierarchy. For further information, see Note 2 (b), "Significant Accounting Policies – Fair Value Measurements":

<b>December 31, 2013</b> <i>(U.S. dollars in thousands)</i>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Other Unobservable Inputs (Level 3)</b>	<b>Collateral and Counterparty Netting</b>	<b>Balance at December 31, 2013</b>
<b>Assets</b>					
U.S. Government and Government - Related/Supported.....	\$ -	\$ 2,147,892	\$ -	\$ -	\$ 2,147,892
Corporate (1) (2) .....	-	10,637,195	31,535	-	10,668,730
Residential mortgage-backed securities – Agency ("RMBS - Agency") .....	-	3,196,275	10,473	-	3,206,748
Residential mortgage-backed securities – Non-Agency ("RMBS - Non-Agency") .....	-	255,343	9	-	255,352
Commercial mortgage-backed securities ("CMBS") .....	-	1,181,612	12,533	-	1,194,145
Collateralized debt obligations ("CDO") .....	-	7,060	710,253	-	717,313
Other asset-backed securities (2) .....	-	1,138,875	11,877	-	1,150,752
U.S. States and political subdivisions of the States .....	-	1,843,794	-	-	1,843,794
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	-	4,870,004	-	-	4,870,004
Total fixed maturities, at fair value .....	\$ -	\$ 25,278,050	\$ 776,680	\$ -	\$ 26,054,730
Equity securities, at fair value (3) .....	540,332	499,905	-	-	1,040,237
Short-term investments, at fair value (4) .....	-	355,440	2,015	-	357,455
Total investments available for sale .....	\$ 540,332	\$ 26,133,395	\$ 778,695	\$ -	\$ 27,452,422
Cash equivalents (5) .....	822,503	226,636	-	-	1,049,139
Other investments (6) .....	-	756,981	109,004	-	865,985
Other assets (7) .....	-	27,487	-	(1,342)	26,145
Total assets accounted for at fair value .....	<u>\$ 1,362,835</u>	<u>\$ 27,144,499</u>	<u>\$ 887,699</u>	<u>\$ (1,342)</u>	<u>\$ 29,393,691</u>
<b>Liabilities</b>					
Financial instruments sold, but not yet purchased (8) .....	\$ -	\$ 28,861	\$ -	\$ -	\$ 28,861
Other liabilities (7) .....	-	76,375	29,110	(1,342)	104,143
Total liabilities accounted for at fair value .....	<u>\$ -</u>	<u>\$ 105,236</u>	<u>\$ 29,110</u>	<u>\$ (1,342)</u>	<u>\$ 133,004</u>

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**3. Fair Value Measurements**

<b>December 31, 2012</b> <i>(U.S. dollars in thousands)</i>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Other Unobservable Inputs (Level 3)</b>	<b>Collateral and Counterparty Netting</b>	<b>Balance at December 31, 2012</b>
<b>Assets</b>					
U.S. Government and Government - Related/Supported.....	\$ -	\$ 1,968,149	\$ -	\$ -	\$ 1,968,149
Corporate (1) (2) .....	-	9,944,450	30,060	-	9,974,510
RMBS – Agency .....	-	4,861,413	32,005	-	4,893,418
RMBS – Non-Agency .....	-	540,473	116	-	540,589
CMBS .....	-	981,869	25,347	-	1,007,216
CDO .....	-	8,080	701,736	-	709,816
Other asset-backed securities (2) .....	-	1,407,245	18,128	-	1,425,373
U.S. States and political subdivisions of the States .....	-	1,890,316	-	-	1,890,316
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	-	4,251,137	-	-	4,251,137
Total fixed maturities, at fair value (2) .....	\$ -	\$ 25,853,132	\$ 807,392	\$ -	\$ 26,660,524
Equity securities, at fair value (3) .....	253,957	395,402	-	-	649,359
Short-term investments, at fair value (4) .....	-	322,703	-	-	322,703
Total investments available for sale .....	\$ 253,957	\$ 26,571,237	\$ 807,392	\$ -	\$ 27,632,586
Cash equivalents (5) .....	1,357,142	408,292	-	-	1,765,434
Other investments (6) .....	-	792,240	107,741	-	899,981
Other assets (7) .....	-	24,842	-	(1,327)	23,515
Total assets accounted for at fair value .....	<u>\$ 1,611,099</u>	<u>\$ 27,796,611</u>	<u>\$ 915,133</u>	<u>\$ (1,327)</u>	<u>\$ 30,321,516</u>
<b>Liabilities</b>					
Financial instruments sold, but not yet purchased (8) .....	\$ -	\$ 26,235	\$ -	\$ -	\$ 26,235
Other liabilities (7) .....	-	30,379	36,247	(1,327)	65,299
Total liabilities accounted for at fair value .....	<u>\$ -</u>	<u>\$ 56,614</u>	<u>\$ 36,247</u>	<u>\$ (1,327)</u>	<u>\$ 91,534</u>

- (1) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes had a fair value of \$154.6 million and \$194.3 million and an amortized cost of \$147.7 million and \$194.8 million at December 31, 2013 and December 31, 2012, respectively. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.
- (2) The Company invests in covered bonds issued by financial institutions (“Covered Bonds”). Covered Bonds are senior secured debt instruments issued by financial institutions and backed by over-collateralized pools of public sector or mortgage loans. At December 31, 2013 December 31, 2012, Covered Bonds with a fair value of \$551.8 million and \$620.9 million, respectively, are included within Other asset-backed securities.
- (3) Included within Equity securities are investments in fixed income funds with a fair value of \$87.4 million and \$101.9 million at December 31, 2013 and December 31, 2012, respectively.
- (4) Short-term investments consist primarily of Corporate securities and U.S. and Non-U.S. Government and Government-Related/Supported securities.
- (5) Cash equivalents balances subject to fair value measurement include certificates of deposit and money market funds. Operating cash balances are not subject to fair value measurement guidance.
- (6) The Other investments balance excludes certain structured transactions including certain investments in project finance transactions, a payment obligation and liquidity financing provided to a structured credit vehicle as a part of a third party medium term note facility. These investments, which totaled \$294.0 million at December 31, 2013 and \$312.1 million at December 31, 2012, are carried at amortized cost. For further information, see Note 6, “Other Investments”
- (7) Other assets and other liabilities include derivative instruments. The derivative balances included in each category are reported on a gross basis by level with a netting adjustment presented separately in the Collateral and Counterparty Netting column. The fair values of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy. For further details regarding derivative fair vales and associated collateral received or paid see Note 13, “Derivative Instruments.”
- (8) Financial instruments sold, but not yet purchased, represent “short sales” and are included within “Payable for investments purchased” on the balance sheet.



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**3. Fair Value Measurements**

**(b) Level 3 Assets and Liabilities**

The tables below present additional information about assets and liabilities measured at fair value on a recurring basis and for which Level 3 inputs were utilized to determine fair value. The tables present a reconciliation of the beginning and ending balances for the years ended December 31, 2013 and 2012 for all financial assets and liabilities measured at fair value using significant unobservable inputs (Level 3) at December 31, 2013 and 2012, respectively. The tables do not include gains or losses that were reported in Level 3 in prior periods for assets that were transferred out of Level 3 prior to December 31, 2013 and 2012. Gains and losses for assets and liabilities classified within Level 3 in the table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Further, it should be noted that the following tables do not take into consideration the effect of offsetting Level 1 and 2 financial instruments entered into by the Company that are either economically hedged by certain exposures to the Level 3 positions or that hedge the exposures in Level 3 positions.

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

There were no significant transfers between Level 1 and Level 2 during the years ended December 31, 2013 and 2012.

**Level 3 Assets and Liabilities - Year Ended December 31, 2013**

<i>(U.S. dollars in thousands)</i>	<b>Corporate</b>	<b>RMBS - Agency</b>	<b>RMBS - Non Agency</b>	<b>CMBS</b>	<b>CDO</b>
Balance, beginning of period .....	\$ 30,060	\$ 32,005	\$ 116	\$ 25,347	\$ 701,736
Realized gains (losses) .....	112	2	(1)	4	4,304
Movement in unrealized gains (losses) .....	839	(52)	(1)	(70)	37,945
Purchases and issuances .....	9,889	843	-	-	133,317
Sales and settlements .....	(7,229)	(4,250)	(105)	(12,748)	(167,049)
Transfers into Level 3 .....	-	-	-	-	-
Transfers out of Level 3 .....	(2,136)	(18,075)	-	-	-
Balance, end of period .....	<u>\$ 31,535</u>	<u>\$ 10,473</u>	<u>\$ 9</u>	<u>\$ 12,533</u>	<u>\$ 710,253</u>
Movement in total gains (losses) above relating to instruments still held at the reporting date .....	<u>\$ 1,031</u>	<u>\$ (50)</u>	<u>\$ 1</u>	<u>\$ (65)</u>	<u>\$ 33,205</u>

**Level 3 Assets and Liabilities - Year Ended December 31, 2013**

<i>(U.S. dollars in thousands)</i>	<b>Other asset-backed securities</b>	<b>Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported</b>	<b>Short-term investments</b>	<b>Other investments</b>	<b>Derivative Contracts - Net</b>
Balance, beginning of period .....	\$ 18,128	\$ -	\$ -	\$ 107,741	\$ (36,247)
Realized gains (losses) .....	51	-	(17)	3,793	-
Movement in unrealized gains (losses) .....	1,455	-	16	7,162	7,137
Purchases and issuances .....	7,009	-	2,016	17,608	-
Sales and settlements .....	(8,258)	-	-	(28,032)	-
Transfers into Level 3 .....	-	-	-	732	-
Transfers out of Level 3 .....	(6,508)	-	-	-	-
Balance, end of period .....	<u>\$ 11,877</u>	<u>\$ -</u>	<u>\$ 2,015</u>	<u>\$ 109,004</u>	<u>\$ (29,110)</u>
Movement in total gains (losses) above relating to instruments still held at the reporting date .....	<u>\$ (11)</u>	<u>\$ -</u>	<u>\$ (1)</u>	<u>\$ 9,933</u>	<u>\$ 7,137</u>

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**3. Fair Value Measurements**

**Level 3 Assets and Liabilities - Year Ended December 31, 2012**

*(U.S. dollars in thousands)*

	<b>Corporate</b>	<b>RMBS - Agency</b>	<b>RMBS - Non Agency</b>	<b>CMBS</b>	<b>CDO</b>
Balance, beginning of period .....	\$ 21,787	\$ 32,041	\$ -	\$ -	\$ 649,572
Realized gains (losses) .....	4	(15)	-	-	(896)
Movement in unrealized gains (losses) .....	99	27	-	20	109,283
Purchases and issuances .....	10,278	-	-	25,546	1,232
Sales and settlements .....	(282)	(6,307)	-	(219)	(56,984)
Transfers into Level 3 .....	2,813	21,249	116	-	-
Transfers out of Level 3 .....	(4,639)	(14,990)	-	-	(471)
Balance, end of period .....	<u>\$ 30,060</u>	<u>\$ 32,005</u>	<u>\$ 116</u>	<u>\$ 25,347</u>	<u>\$ 701,736</u>
Movement in total gains (losses) above relating to instruments still held at the reporting date .....	<u>\$ 122</u>	<u>\$ 10</u>	<u>\$ -</u>	<u>\$ 20</u>	<u>\$ 104,474</u>

**Level 3 Assets and Liabilities - Year Ended December 31, 2012**

	<b>Other asset-backed securities</b>	<b>Non-US Sovereign Government, Provincial, Supranational and Government Related/Supported</b>	<b>Short-term investments</b>	<b>Other investments</b>	<b>Derivative Contracts - Net</b>
Balance, beginning of period .....	\$ 12,933	\$ -	\$ -	\$ 106,290	\$ (42,644)
Realized gains (losses) .....	6,768	-	-	3,980	-
Movement in unrealized gains (losses) .....	(2,785)	-	-	7,625	6,397
Purchases and issuances .....	12,373	-	-	7,376	-
Sales and settlements .....	(16,094)	-	-	(17,535)	-
Transfers into Level 3 .....	4,933	-	-	5	-
Transfers out of Level 3 .....	-	-	-	-	-
Balance, end of period .....	<u>\$ 18,128</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 107,741</u>	<u>\$ (36,247)</u>
Movement in total gains (losses) above relating to instruments still held at the reporting date .....	<u>\$ (154)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,038</u>	<u>\$ 6,397</u>

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**3. Fair Value Measurements**

**(c) Fixed maturities and short-term investments**

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

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

**(d) Other investments**

Included within the Other investments component of the Company's Level 3 valuations are private investments and alternative fund investments where the Company is not deemed to have significant influence over the investee. The fair value of these investments is based upon net asset values received from the investment manager or general partner of the respective entity. The nature of the underlying investments held by the investee that form the basis of the net asset value include assets such as private business ventures and are such that significant Level 3 inputs are utilized in the determination of the individual underlying holding values and, accordingly, the fair value of the Company's investment in each entity is classified within Level 3. The Company has not adjusted the net asset values received; however, management incorporates factors such as the most recent financial information received, annual audited financial statements and the values at which capital transactions with the investee take place when applying judgment regarding whether any adjustments should be made to the net asset value in recording the fair value of each position. Investments in alternative funds included in Other investments utilize strategies including arbitrage, directional, event driven and multi-style. These funds potentially have lockup and gate provisions which may limit redemption liquidity. For further details regarding the nature of Other investments and related features see Note 6, "Other Investments," for further details.

**(e) Derivative instruments**

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

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**3. Fair Value Measurements**

**(f) Financial Instruments Not Carried at Fair Value**

Authoritative guidance over disclosures about the fair value of financial instruments requires additional disclosure of fair value information for financial instruments not carried at fair value in both interim and annual reporting periods. Certain financial instruments, particularly insurance contracts, are excluded from these fair value disclosure requirements. The carrying values of cash and cash equivalents, accrued investment income, net receivable from investments sold, other assets, net payable for investments purchased, other liabilities and other financial instruments not included below approximated their fair values. The following table includes financial instruments for which the carrying value differs from the estimated fair values at December 31, 2013 and 2012. All of these fair value estimates are considered Level 2 fair value measurements. The fair values for fixed maturities held to maturity are provided by third party pricing vendors and significant valuation inputs for all other items included were based upon market data obtained from sources independent of the Company, and are subject to the same control environment previously described.

	December 31, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>(U.S. dollars in thousands)</i>				
Fixed maturities, held to maturity .....	\$ 2,858,695	\$ 3,131,235	\$ 2,814,447	\$ 3,262,804
Other investments - structured transactions .....	294,048	296,799	312,122	293,813
<b>Financial Assets .....</b>	<b>\$ 3,152,743</b>	<b>\$ 3,428,034</b>	<b>\$ 3,126,569</b>	<b>\$ 3,556,617</b>
Deposit liabilities .....	\$ 1,509,243	\$ 1,718,394	\$ 1,551,398	\$ 1,878,499
<b>Financial Liabilities .....</b>	<b>\$ 1,509,243</b>	<b>\$ 1,718,394</b>	<b>\$ 1,551,398</b>	<b>\$ 1,878,499</b>

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

Deposit liabilities include obligations under structured insurance and reinsurance transactions. For purposes of fair value disclosures, the Company determined the estimated fair value of the deposit liabilities by assuming a discount rate equal to the appropriate U.S. Treasury rate plus 56.7 basis points at December 31, 2013 and the appropriate U.S. Treasury rate plus 100.3 basis points at December 31, 2012. The discount rate incorporates the Company's own credit risk into the determination of estimated fair value.

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

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**4. Investments**

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

*Amortized Cost and Fair Value Summary*

The cost (amortized cost for fixed maturities and short-term investments), fair value, gross unrealized gains and gross unrealized (losses), including, OTTI recorded in accumulated other comprehensive income ("AOCI") of the Company's available for sale ("AFS") and held to maturity ("HTM") investments at December 31, 2013 and December 31, 2012 were as follows:

		Included in AOCI			Non-credit Related OTTI (1)
		Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Related to Changes in Estimated Fair Value	
December 31, 2013					
(U.S. dollars in thousands)					
Fixed maturities - AFS					
U.S. Government and Government- Related/Supported(2) \$	2,128,863	\$ 50,001	\$ (30,972)	\$ 2,147,892	\$ -
Corporate (3) (4) (5).....	10,378,004	401,187	(110,461)	10,668,730	(4,758)
RMBS – Agency .....	3,209,148	59,665	(62,065)	3,206,748	-
RMBS – Non-Agency .....	240,001	26,097	(10,746)	255,352	(23,287)
CMBS.....	1,176,303	33,399	(15,557)	1,194,145	(1,380)
CDO .....	754,336	5,833	(42,856)	717,313	(2,036)
Other asset-backed securities (3).....	1,119,000	40,503	(8,751)	1,150,752	(2,807)
U.S. States and political subdivisions of the States .....	1,819,743	54,830	(30,779)	1,843,794	-
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) .....	4,873,529	80,735	(84,260)	4,870,004	-
<b>Total fixed maturities - AFS .....</b>	<b>\$ 25,698,927</b>	<b>\$ 752,250</b>	<b>\$ (396,447)</b>	<b>\$ 26,054,730</b>	<b>\$ (34,268)</b>
<b>Total short-term investments (2).....</b>	<b>\$ 356,595</b>	<b>\$ 960</b>	<b>\$ (100)</b>	<b>\$ 357,455</b>	<b>\$ -</b>
<b>Total equity securities .....</b>	<b>\$ 903,201</b>	<b>\$ 154,506</b>	<b>\$ (17,470)</b>	<b>\$ 1,040,237</b>	<b>\$ -</b>
<b>Total investments - AFS .....</b>	<b>\$ 26,958,723</b>	<b>\$ 907,716</b>	<b>\$ (414,017)</b>	<b>\$ 27,452,422</b>	<b>\$ (34,268)</b>
Fixed maturities - HTM					
U.S. Government and Government- Related/Supported (2).....	\$ 10,993	\$ 629	\$ -	\$ 11,622	\$ -
Corporate (3) .....	1,386,863	113,179	(968)	1,499,074	-
RMBS – Non-Agency .....	66,987	4,985	-	71,972	-
CMBS.....	144,924	11,864	-	156,788	-
Other asset-backed securities (3).....	106,540	6,908	-	113,448	-
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) .....	1,142,388	136,585	(642)	1,278,331	-
<b>Total investments - HTM .....</b>	<b>\$ 2,858,695</b>	<b>\$ 274,150</b>	<b>\$ (1,610)</b>	<b>\$ 3,131,235</b>	<b>\$ -</b>

- (1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.
- (2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$2,229.0 million and fair value of \$2,262.7 million and U.S. Agencies with an amortized cost of \$221.8 million and fair value of \$239.1 million.
- (3) At December 31, 2013, Covered Bonds within Fixed maturities – AFS with an amortized cost of \$525.2 million and a fair value of \$551.8 million and Covered Bonds within Fixed maturities – HTM with an amortized cost of \$8.6 million and a fair value of \$8.7 million have been included within Other asset-backed securities to align the Company's classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.
- (4) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of \$154.6 million and an amortized cost of \$147.7 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.
- (5) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$281.8 million and an amortized cost of \$285.8 million at December 31, 2013.

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		Included in AOCI				
				Gross Unrealized Losses Related to Changes in Estimated Fair Value	Fair Value	Non-credit Related OTTI (1)
December 31, 2012		Cost or Amortized Cost	Gross Unrealized Gains			
(U.S. dollars in thousands)						
Fixed maturities - AFS						
U.S. Government and Government- Related/Supported						
(2).....	\$	1,845,287	\$ 126,151	\$ (3,289)	\$ 1,968,149	\$ -
Corporate (3) (4) (5).....		9,382,573	671,402	(79,465)	9,974,510	(11,453)
RMBS – Agency .....		4,723,875	175,440	(5,897)	4,893,418	-
RMBS – Non-Agency .....		540,719	40,025	(40,155)	540,589	(38,917)
CMBS.....		950,183	60,507	(3,474)	1,007,216	(1,524)
CDO .....		784,564	12,008	(86,756)	709,816	(4,872)
Other asset-backed securities (3).....		1,380,985	57,782	(13,394)	1,425,373	(5,761)
U.S. States and political subdivisions of the States .....		1,749,452	143,815	(2,951)	1,890,316	-
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) .....		4,071,825	187,505	(8,193)	4,251,137	-
<b>Total fixed maturities - AFS .....</b>	\$	25,429,463	\$ 1,474,635	\$ (243,574)	\$ 26,660,524	\$ (62,527)
<b>Total short-term investments (2) .....</b>	\$	322,561	\$ 192	\$ (50)	\$ 322,703	\$ -
<b>Total equity securities .....</b>	\$	617,486	\$ 31,935	\$ (62)	\$ 649,359	\$ -
<b>Total investments - AFS .....</b>	\$	26,369,510	\$ 1,506,762	\$ (243,686)	\$ 27,632,586	\$ (62,527)
Fixed maturities - HTM						
U.S. Government and Government- Related/Supported						
(2).....	\$	10,788	\$ 1,651	\$ -	\$ 12,439	\$ -
Corporate (3) .....		1,425,320	190,871	(794)	1,615,397	-
RMBS – Non-Agency .....		83,205	10,502	-	93,707	-
CMBS.....		12,751	2,048	-	14,799	-
Other asset-backed securities (3).....		222,340	29,287	(167)	251,460	-
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported (2) .....		1,060,043	216,679	(1,720)	1,275,002	-
<b>Total investments - HTM .....</b>	\$	2,814,447	\$ 451,038	\$ (2,681)	\$ 3,262,804	\$ -

- (1) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.
- (2) U.S. Government and Government-Related/Supported, Non-U.S. Sovereign Government, Provincials, Supranationals and Government-Related/Supported and Total short-term investments includes government-related securities with an amortized cost of \$1,905.9 million and fair value of \$2,000.8 million and U.S. Agencies with an amortized cost of \$343.1 million and fair value of \$384.7 million.
- (3) At December 31, 2012, Covered Bonds within Fixed maturities – AFS with an amortized cost of \$572.5 million and a fair value of \$612.3 million and Covered Bonds within Fixed maturities – HTM with an amortized cost of \$8.4 million and a fair value of \$8.6 million have been included within Other asset-backed securities to align the Company's classification to market indices. Covered Bonds were included in Corporate prior to January 1, 2012.
- (4) Included within Corporate are certain medium term notes supported primarily by pools of European investment grade credit with varying degrees of leverage. The notes have a fair value of \$194.3 million and an amortized cost of \$194.8 million. These notes allow the investor to participate in cash flows of the underlying bonds including certain residual values, which could serve to either decrease or increase the ultimate values of these notes.
- (5) Included within Corporate are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions. These securities have a fair value of \$308.5 million and an amortized cost of \$327.6 million at December 31, 2012.

At December 31, 2013 and December 31, 2012, approximately 2.6% and 2.8%, respectively, of the Company's fixed income investment portfolio at carrying value was invested in securities that were below investment grade or not rated. Approximately 10.0% and 33.1% of the gross unrealized losses in the Company's fixed income securities portfolio at December 31, 2013 and December 31, 2012, respectively, related to securities that were below investment grade or not rated.

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*Contractual Maturities Summary*

The contractual maturities of AFS and HTM fixed income securities at December 31, 2013 and December 31, 2012 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2013 (1)		December 31, 2012 (1)	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(U.S. dollars in thousands)</i>				
<b>Fixed maturities - AFS</b>				
Due less than one year .....	\$ 1,901,440	\$ 1,906,889	\$ 1,865,204	\$ 1,875,431
Due after 1 through 5 years .....	9,479,949	9,693,454	8,070,795	8,386,835
Due after 5 through 10 years .....	5,424,881	5,455,741	4,676,640	5,032,229
Due after 10 years .....	2,393,869	2,474,336	2,436,498	2,789,617
	<u>\$ 19,200,139</u>	<u>\$ 19,530,420</u>	<u>\$ 17,049,137</u>	<u>\$ 18,084,112</u>
RMBS – Agency .....	3,209,148	3,206,748	4,723,875	4,893,418
RMBS – Non-Agency .....	240,001	255,352	540,719	540,589
CMBS .....	1,176,303	1,194,145	950,183	1,007,216
CDO .....	754,336	717,313	784,564	709,816
Other asset-backed securities .....	1,119,000	1,150,752	1,380,985	1,425,373
Total mortgage and asset-backed securities .....	<u>\$ 6,498,788</u>	<u>\$ 6,524,310</u>	<u>\$ 8,380,326</u>	<u>\$ 8,576,412</u>
<b>Total fixed maturities - AFS .....</b>	<b>\$ 25,698,927</b>	<b>\$ 26,054,730</b>	<b>\$ 25,429,463</b>	<b>\$ 26,660,524</b>
<b>Fixed maturities - HTM</b>				
Due less than one year .....	\$ 65,651	\$ 66,766	\$ 36,515	\$ 37,580
Due after 1 through 5 years .....	240,802	255,322	195,121	205,562
Due after 5 through 10 years .....	455,633	492,095	377,541	420,008
Due after 10 years .....	1,778,158	1,974,844	1,886,974	2,239,688
	<u>\$ 2,540,244</u>	<u>\$ 2,789,027</u>	<u>\$ 2,496,151</u>	<u>\$ 2,902,838</u>
RMBS – Non-Agency .....	66,987	71,972	83,205	93,707
CMBS .....	144,924	156,788	12,751	14,799
Other asset-backed securities .....	106,540	113,448	222,340	251,460
Total mortgage and asset-backed securities .....	<u>\$ 318,451</u>	<u>\$ 342,208</u>	<u>\$ 318,296</u>	<u>\$ 359,966</u>
<b>Total fixed maturities - HTM .....</b>	<b>\$ 2,858,695</b>	<b>\$ 3,131,235</b>	<b>\$ 2,814,447</b>	<b>\$ 3,262,804</b>

- (1) Included in the table above are Tier One and Upper Tier Two securities, representing committed term debt and hybrid instruments, which are senior to the common and preferred equities of the financial institutions, at their fair value of \$281.8 million and \$308.5 million at December 31, 2013 and December 31, 2012, respectively. These securities are reflected in the table based on their call date and have net unrealized losses of \$4.1 million and \$19.1 million at December 31, 2013 and December 31, 2012, respectively.

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***OTTI Considerations***

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

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

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

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

***Pledged Assets***

Certain of the Company’s invested assets are held in trust and pledged in support of insurance and reinsurance liabilities as well as credit facilities. Such pledges are largely required by the Company’s operating subsidiaries that are “non-admitted” under U.S. state insurance regulations, in order for the U.S. cedant to receive statutory credit for reinsurance. Also, certain deposit liabilities and annuity contracts require the use of pledged assets. At December 31, 2013 and December 31, 2012, the Company had \$15.3 billion and \$16.2 billion in pledged assets, respectively.



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**(b) Gross Unrealized Losses**

The following is an analysis of how long the AFS and HTM securities at December 31, 2013 and December 31, 2012 had been in a continual unrealized loss position:

	Less than 12 months		Equal to or greater than 12 months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>December 31, 2013</b>				
<i>(U.S. dollars in thousands)</i>				
<b>Fixed maturities and short-term investments - AFS</b>				
U.S. Government and Government-Related/Supported .....	\$ 1,016,128	\$ (27,403)	\$ 44,158	\$ (3,614)
Corporate .....	2,723,925	(60,353)	513,068	(50,122)
RMBS – Agency .....	1,385,945	(50,375)	165,935	(11,690)
RMBS – Non-Agency .....	6,412	(247)	103,384	(10,499)
CMBS .....	445,729	(7,183)	105,662	(8,374)
CDO .....	58,239	(217)	574,391	(42,639)
Other asset-backed securities .....	141,329	(2,134)	96,331	(6,617)
U.S. States and political subdivisions of the States .....	464,150	(23,133)	64,324	(7,646)
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	2,130,792	(56,866)	306,873	(27,435)
<b>Total fixed maturities and short-term investments - AFS .....</b>	<b>\$ 8,372,649</b>	<b>\$ (227,911)</b>	<b>\$ 1,974,126</b>	<b>\$ (168,636)</b>
<b>Total equity securities .....</b>	<b>\$ 155,453</b>	<b>\$ (17,470)</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Fixed maturities -HTM</b>				
Corporate .....	\$ 46,034	\$ (941)	\$ 642	\$ (27)
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	-	-	11,894	(642)
<b>Total fixed maturities - HTM .....</b>	<b>\$ 46,034</b>	<b>\$ (941)</b>	<b>\$ 12,536</b>	<b>\$ (669)</b>

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**4. Investments**

	Less than 12 months		Equal to or greater than 12 months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>December 31, 2012</b>				
<i>(U.S. dollars in thousands)</i>				
<b>Fixed maturities and short-term investments - AFS</b>				
U.S. Government and Government-Related/Supported .....	\$ 325,937	\$ (2,847)	\$ 9,951	\$ (471)
Corporate .....	475,977	(11,116)	607,758	(68,349)
RMBS – Agency .....	632,393	(4,903)	11,135	(994)
RMBS – Non-Agency .....	8,090	(495)	290,196	(39,660)
CMBS .....	96,649	(675)	20,501	(2,799)
CDO .....	243	(1)	693,211	(86,755)
Other asset-backed securities .....	120,390	(535)	90,586	(12,859)
U.S. States and political subdivisions of the States .....	77,955	(1,412)	12,851	(1,539)
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	355,409	(1,378)	131,884	(6,836)
<b>Total fixed maturities and short-term investments - AFS .....</b>	<b>\$ 2,093,043</b>	<b>\$ (23,362)</b>	<b>\$ 1,868,073</b>	<b>\$ (220,262)</b>
<b>Total equity securities .....</b>	<b>\$ 615</b>	<b>\$ (62)</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Fixed maturities - HTM</b>				
Corporate .....	\$ 4,568	\$ (31)	\$ 23,005	\$ (763)
Other asset-backed securities .....	1,239	(167)	-	-
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported .....	-	-	10,518	(1,720)
<b>Total fixed maturities - HTM .....</b>	<b>\$ 5,807</b>	<b>\$ (198)</b>	<b>\$ 33,523</b>	<b>\$ (2,483)</b>

The Company had gross unrealized losses totaling \$410.0 million on 2,237 securities out of a total of 7,616 held at December 31, 2013 in its AFS portfolio and \$1.6 million on 4 securities out of a total of 203 held in its HTM portfolio, which it considers to be temporarily impaired or with respect to which reflects non-credit losses on OTTI. Individual security positions comprising this balance have been evaluated by management to determine the severity of these impairments and whether they should be considered other-than-temporary. Management believes it is more likely than not that the issuer will be able to fund sufficient principal and interest payments to support the current amortized cost.

Management, in its assessment of whether securities in a gross unrealized loss position are temporarily impaired, as described above, considers the significance of the impairments. At December 31, 2013, the Company had structured credit securities with gross unrealized losses of \$12.1 million, which had a fair value of \$4.1 million, and a cumulative fair value decline of greater than 50% of amortized cost. All of these securities are mortgage and asset-backed securities. These greater than 50% impaired securities include gross unrealized losses of \$0.2 million on non-Agency RMBS, \$11.4 million on Core CDOs and \$0.5 million of CMBS holdings.

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**4. Investments**

**(c) Net Investment Income**

Net investment income for the years ended December 31 is derived from the following sources:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Fixed maturities, short term investments and cash equivalents .....	\$ 932,370	\$ 1,006,005
Equity securities and other investments .....	35,344	29,807
Funds withheld .....	12,783	12,082
Total gross investment income .....	980,497	1,047,894
Investment expenses .....	(70,398)	(72,289)
Net investment income .....	<u>\$ 910,099</u>	<u>\$ 975,605</u>

**(d) Net Realized Gains (Losses)**

The following represents an analysis of net realized gains (losses) and the change in unrealized gains (losses) on investments for the years ended December 31:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Net realized gains (losses):		
Fixed maturities, short term investments, cash and cash equivalents:		
Gross realized gains .....	\$ 108,456	\$ 217,425
Gross realized losses on investments sold .....	(90,279)	(106,442)
OTTI on investments, net of amounts transferred to other comprehensive income .....	(12,342)	(50,073)
Net realized gains (losses) .....	5,835	60,910
Equity securities:		
Gross realized gains .....	29,350	42,009
Gross realized losses on investments sold .....	(3,185)	(7,121)
OTTI on investments, net of amounts transferred to other comprehensive income .....	(17)	(3,746)
Net realized gains (losses) .....	26,148	31,142
Other investments:		
Gross realized gains .....	46,887	11,589
Gross realized losses on investments sold .....	(13,743)	(7,889)
OTTI on investments, net of amounts transferred to other comprehensive income .....	-	(2,721)
Net realized gains (losses) .....	33,144	979
Net realized gains (losses) on investments .....	65,127	93,031
Net realized and unrealized gains (losses) on investment related derivative instruments ..	6,366	(1,203)
Net realized gains (losses) on investments and net realized and unrealized gains (losses) on investment related derivative instruments .....	71,493	91,828
Change in unrealized gains (losses):		
Fixed maturities - AFS .....	(874,540)	757,997
Fixed maturities - HTM .....	(175,817)	221,647
Equity securities .....	105,163	44,361
Affiliates and other investments .....	29,702	45,984
Net change in unrealized gains (losses) on investments .....	(915,492)	1,069,989
Total net realized gains (losses) on investments, net realized and unrealized gains (losses) on investment related derivative instruments, and net change in unrealized gains (losses) on investments .....	<u>\$ (843,999)</u>	<u>\$ 1,161,817</u>

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**4. Investments**

The significant components of the net impairment charges of \$12.3 million for the year ended December 31, 2013 were:

- \$3.7 million for structured securities, principally non-Agency RMBS, where we determined that the likely recovery on these securities was below the carrying value and, accordingly, recorded an impairment of the securities to the discounted value of the cash flows expected to be received on these securities.
- \$4.3 million related to medium term notes backed primarily by European investment grade credit. On certain notes, management concluded that expected future returns on the underlying assets were not sufficient to support the previously reported amortized cost.
- \$4.3 million related to foreign exchange losses.

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

**Credit Loss Impairments**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Balance at January 1, .....	\$ 165,562	\$ 202,235
Credit loss impairment recognized in the current period on securities not previously impaired.....	676	10,060
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period.....	(64,441)	(65,453)
Credit loss impairments previously recognized on securities impaired to fair value during the period..	-	3,286
Additional credit loss impairments recognized in the current period on securities previously impaired .....	6,773	30,552
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected .....	(6,609)	(15,118)
Balance at December 31, .....	<u>\$ 101,961</u>	<u>\$ 165,562</u>

During the year ended December 31, 2013 and 2012, the \$64.4 million and \$65.4 million, respectively, of credit loss impairments previously recognized on securities that matured, or were paid down, prepaid or sold, includes \$40.1 million and \$16.2 million, respectively, of non-Agency RMBS.

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**5. Investments In Affiliates**

The Company's investment portfolio includes certain investments over which the company is considered to have significant influence and which, therefore, are accounted for using the equity method. 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 more in closed end funds, limited partnerships, LLCs or similar investment vehicles. The Company generally records its alternative and private equity fund affiliates on a one-month and three-month lag, respectively, and its operating affiliates on a three-month lag. See Note 6, "Other Investments" for investments in alternative and private equity funds in which the Company generally owns less than 3% and are accounted for as "Other Investments."

Investments in affiliates comprised the following at December 31, 2013 and 2012:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Investment fund affiliates .....	\$ 1,042,072	\$ 845,197
Operating affiliates .....	328,871	281,678
Total investment affiliates.....	<u>\$ 1,370,943</u>	<u>\$ 1,126,875</u>

**(a) Investment Fund Affiliates**

The Company has invested in certain closed end funds, certain limited partnerships, LLCs and similar investment vehicles, including funds managed by certain of its investment manager affiliates. Collectively, these investments in funds, partnerships and other vehicles are classified as "investment fund affiliates." The Company's equity investment in investment fund affiliates and equity in net income (loss) from such affiliates as well as certain summarized financial information of the investee as a whole (shown as "Combined Funds") are included below:

	<b>XL Investment</b>			<b>Combined Funds</b>
	<b>Carrying Value</b>	<b>Equity in Net Income (Loss) for the Year</b>	<b>Weighted Average XL Percentage Ownership</b>	<b>Total Net Assets (Estimated) (2)</b>
<b>Year Ended December 31, 2013</b>				
<i>(U.S. dollars in thousands, except percentages)</i>				
Alternative Funds (1):				
Arbitrage .....	\$ 158,096	\$ 4,358	3.7%	\$ 4,328,748
Directional .....	434,652	42,492	8.3%	5,235,690
Event Driven (3).....	274,380	61,551	2.9%	9,309,163
Multi-Style .....	374	48	15.5%	2,410
Total alternative funds.....	<u>\$ 867,502</u>	<u>\$ 108,449</u>	4.6%	<u>\$ 18,876,011</u>
Private Investment Funds (1):	174,570	29,939	19.6%	890,815
<b>Total Investment Fund Affiliates .....</b>	<u><b>\$ 1,042,072</b></u>	<u><b>\$ 138,388</b></u>	5.3%	<u><b>\$ 19,766,826</b></u>
<b>Year Ended December 31, 2012</b>				
Alternative Funds (1):				
Arbitrage .....	\$ 131,037	\$ 7,149	3.7%	\$ 3,517,404
Directional .....	297,535	14,791	5.9%	5,057,381
Event Driven .....	198,282	13,125	2.4%	8,272,227
Multi-Style .....	326	(100)	13.5%	2,410
Total alternative funds.....	<u>\$ 627,180</u>	<u>\$ 34,965</u>	3.7%	<u>\$ 16,849,422</u>
Private Investment Funds (1):	218,017	23,520	17.1%	1,275,543
<b>Total Investment Fund Affiliates .....</b>	<u><b>\$ 845,197</b></u>	<u><b>\$ 58,485</b></u>	4.7%	<u><b>\$ 18,124,965</b></u>

- (1) The Company generally records its alternative fund affiliates on a one-month lag and its private investment fund affiliates on a three-month lag.
- (2) Total estimated net assets are generally as at November 30 and September 30, respectively.
- (3) The Company accounts for its investment in certain funds where the ownership percentage is less than three percent using the equity method, where the Company has significant influence over the related investment management company.

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**5. Investments In Affiliates**

Certain funds have a lock-up period and/or may also have the ability to impose a redemption gate. A lock-up period refers to the initial amount of time an investor is contractually required to remain invested before having the ability to redeem. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash shortly after the redemption date.

The carrying value of the Company's holdings in funds that are subject to lockups and/or that have gate provisions in their governing documents as at December 31, 2013 and 2012 was \$488.5 million and \$302.4 million, respectively. The carrying value of the Company's holdings in funds, where a gate was imposed at December 31, 2013 and 2012 was nil and \$1.4 million, respectively.

Certain funds may be allowed to invest a portion of their assets in illiquid securities, such as private equity or private debt. In such cases, a common mechanism used is a side-pocket, whereby the illiquid security is assigned to a separate memorandum capital account or other designated account. Typically, the investor loses its redemption rights in the designated account. Only when the illiquid securities in the side-pocket are sold, or otherwise deemed liquid by the fund, may investors redeem that portion of their interest that has been "side-pocketed". At December 31, 2013 and 2012, the carrying value of our funds held in side-pockets was \$42.3 million and \$39.7 million, respectively. The underlying assets within these positions are generally expected to be liquidated over a period of approximately two to four years.

**(b) Operating Affiliates**

The Company has invested in investment and (re)insurance affiliates and investment management companies' securities or other forms of ownership interests. Collectively, these investments are classified as "operating affiliates."

The Company's equity investment in operating affiliates and equity in net income (loss) from such affiliates as well as certain summarized financial information of the investee as a whole are included below:

	XL Investment		Combined Investee Summarized Financial Data (Estimated) (1)			
	Carrying Value	Equity in Net Income (Loss) for the Year	Total Assets	Total Liabilities	Total Revenue (Loss)	Net Income (Loss)
<b>Year ended December 31, 2013</b> (U.S. dollars in thousands)						
Other strategic operating affiliates .....	266,796	41,160	2,646,987	1,888,879	902,522	125,625
Investment manager affiliates .....	62,075	78,644	922,348	92,574	813,587	710,412
Total operating affiliates .....	<u>\$ 328,871</u>	<u>\$ 119,804</u>	<u>\$ 3,569,335</u>	<u>\$ 1,981,453</u>	<u>\$ 1,716,109</u>	<u>\$ 836,037</u>
<b>Year ended December 31, 2012</b>						
Financial operating affiliates.....	\$ 732	\$ -	\$ 12,711,762	\$ 12,678,810	\$ 20,467	\$ 6,183
Other strategic operating affiliates .....	192,792	27,033	2,094,539	1,512,551	698,665	51,702
Investment manager affiliates (2) .....	88,154	28,777	610,940	37,699	364,551	274,312
Total operating affiliates .....	<u>\$ 281,678</u>	<u>\$ 55,810</u>	<u>\$ 15,417,241</u>	<u>\$ 14,229,060</u>	<u>\$ 1,083,683</u>	<u>\$ 332,197</u>

(1) The Company generally records its operating affiliates on a three month lag. Estimated assets and liabilities are generally at September 30, 2013 and 2012, respectively.

(2) During the year ended December 31, 2013 and 2012 the Company received distributions from its Investment Manager Affiliates of approximately \$28.3 million and \$58.3 million respectively.

In certain investments, the carrying value is different from the share of the investee's underlying net assets. The differences represent goodwill on acquisition, OTTI recorded with respect to the investment, or differences in the retained capital accounts of the various equity holders (including the Company).

See Note 15(c), "Commitments and Contingencies – Investments in Affiliates," for further information regarding commitments related to investment in affiliates.

**Financial Operating Affiliates**

The Company had no significant financial operating affiliates during 2013 or 2012.

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**5. Investments In Affiliates**

***Other Strategic Operating Affiliates***

At December 31, 2013, the Company's larger strategic operating affiliates included ARX Holding Corporation and Five Oaks Investment Corp. The Company's investment in ARX Holding Corporation was 39.7% at both December 31, 2013 and 2012.

In May 2012, the Company invested \$25.0 million to obtain an approximate 94% interest in Five Oaks Investment Corp. ("Five Oaks"), a newly formed private investment company. Five Oaks is a mortgage real estate investment trust that is focused on investing in, financing and managing a leveraged portfolio of agency and non-agency residential mortgage-backed securities, residential mortgage loans and other mortgage-related investments. At December 31, 2012, the Company had consolidated Five Oaks, resulting in the recording within its balance sheet of: RMBS securities at their fair value of \$81.0 million (amortized cost: \$77.3 million) within Fixed maturities, \$8.4 million of derivatives, \$6.0 million of Cash and cash equivalents, \$63.4 million of liabilities related to obligations under repurchase agreements within Other liabilities, and \$1.8 million of Non-controlling interest in equity of consolidated subsidiaries. \$66.3 million of securities held by Five Oaks and consolidated by the Company were pledged as collateral under the repurchase agreements. The repurchase agreements did not provide the counterparties any recourse to assets of the Company aside from its investment in Five Oaks. Amounts recorded within the Company's consolidated statement of income related to Five Oaks were immaterial during the year ended December 31, 2012.

In March 2013, Five Oaks completed an initial public offering ("IPO") of approximately 4.0 million of its common shares for gross proceeds of approximately \$61.0 million and, concurrently with its IPO, Five Oaks sold to the Company an additional 1.67 million shares for \$25.0 million in a private placement. Following these transactions, and the receipt of 8,175 shares distributed to the Company in respect of its investment in Oak Circle Capital Partners LLC ("Oak Circle"), the Company's ownership interest in Five Oaks was reduced to 43.8%, which no longer represented a controlling financial interest. Accordingly, the Five Oaks investment was deconsolidated by the Company at the closing date of the Five Oaks IPO. The investment is accounted for under the equity method and carried as a strategic operating affiliate at December 31, 2013. The Company generally records the income related to strategic operating affiliates on a three-month lag based upon the availability of the information provided by the investees. A loss of \$1.5 million was recorded upon deconsolidation within Realized investment gains (losses) based upon the difference between the fair value of the Company's retained interest in Five Oaks subsequent to the additional share sales and the Company's carrying value of Five Oaks' net assets at the closing date of the Five Oaks IPO. In addition, in September 2012 the Company received warrants that were priced at the time of the IPO. The warrants allow the Company to purchase an additional 3.125 million shares at \$15.75 per share, which would result in a total additional investment of \$49.2 million by the Company should it exercise the warrants in full in the future. The warrants expire in September 2019.

In March 2012, the Company purchased an equity interest in Oak Circle, the investment management company that provides portfolio management and other administrative services to Five Oaks. The Company's investment in Oak Circle is included in investment manager affiliates.

During 2013, the Company purchased an interest in one additional strategic operating affiliate for \$30.0 million.

***Investment Manager Affiliates***

During the years ended December 31, 2013 and 2012, the Company's larger investment manager affiliates included Highfields Capital, a global equity investment firm, Polar Capital, an investment firm offering traditional and alternative products and HighVista Strategies, a diversified wealth management firm. The Company recorded, through net income in affiliates, other-than-temporary declines in the values of certain investment manager affiliates totaling \$nil, for the years ended December 31, 2013 and 2012, respectively.

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**6. Other Investments**

Contained within this asset class are equity interests in alternative and private investment funds, limited partnerships and unrated tranches of collateralized debt obligations for which the Company does not have sufficient rights or ownership interests to use the equity method of accounting. The Company accounts for such equity securities at estimated fair value with changes in fair value recorded through AOCI as it has no significant influence over these entities. Also included within other investments are structured transactions that are carried at amortized cost.

Other investments comprised the following at December 31, 2013 and 2012:

**Year ended December 31,**

*(U.S. dollars in thousands)*

**Alternative Investment Funds:**

	<b>2013</b>	<b>2012</b>
Arbitrage .....	\$ 158,220	\$ 278,680
Directional .....	357,469	254,616
Event Driven .....	56,873	96,451
Multi-Style .....	72,625	65,125
Total alternative funds .....	\$ 645,187	\$ 694,872
Private investment funds .....	89,598	81,937
Overseas deposits .....	111,302	96,117
Structured transactions .....	294,780	312,122
Other .....	19,166	27,054
Total other investments .....	<u>\$ 1,160,033</u>	<u>\$ 1,212,102</u>

**(a) Alternative and Private Equity Funds**

At December 31, 2013 and 2012, the alternative fund portfolio, accounted for as other investments, employed four strategies invested in 16 and 17 alternative funds, respectively. The Company is able to redeem the hedge funds on the same terms that the underlying funds can be redeemed. In general, the funds in which the Company is invested require at least 30 days notice of redemption, and may be redeemed on a monthly, quarterly, semi-annual, annual or longer basis, depending on the fund.

Certain funds have a lock-up period and/or may also have the ability to impose a redemption gate. A lock-up period refers to the initial amount of time an investor is contractually required to remain invested before having the ability to redeem. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash shortly after the redemption date.

The fair value of the Company's holdings in funds that may be subject to lockups and/or that have gate provisions in their governing documents at December 31, 2013 and 2012 was \$360.6 million and \$335.2 million, respectively. The Company did not have any holdings in funds where a gate was imposed at December 31, 2013 or 2012.

Certain funds may be allowed to invest a portion of their assets in illiquid securities, such as private equity or private debt. In such cases, a common mechanism used is a side-pocket, whereby the illiquid security is assigned to a separate memorandum capital account or other designated account. Typically, the investor loses its redemption rights in the designated account. Only when the illiquid securities in the side-pocket are sold, or otherwise deemed liquid by the fund, may investors redeem that portion of their interest that has been "side-pocketed". At December 31, 2013 and 2012, the fair value of our funds held in side-pockets was \$24.1 million and \$25.0 million, respectively. The underlying assets within these positions are generally expected to be liquidated over a period of approximately two to four years.

An increase in market volatility and an increase in the volatility of hedge funds in general, as well as a decrease in market liquidity, could lead to a higher risk of a large decline in the value of the hedge funds in any given time period.

The following represents an analysis of the net realized gains and the net unrealized gains on the Company's alternative investment funds and private equity funds:



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**6. Other Investments**

Year ended December 31, (U.S. dollars in thousands)	<u>Net Unrealized Gains (Losses)</u>		<u>Net Realized Gains (Losses)</u>	
	2013	2012	2013	2012
Alternative investment funds .....	\$ 158,825	\$ 130,702	\$ 30,858	\$ (2,153)
Private investment funds .....	39,561	30,986	577	-
Total .....	<u>\$ 198,386</u>	<u>\$ 161,688</u>	<u>\$ 31,435</u>	<u>\$ (2,153)</u>

**(b) Overseas Deposits**

Overseas deposits include investments in private funds related to Lloyd's syndicates in which the underlying instruments are primarily government and government-related/supported and corporate fixed income securities. The funds themselves do not trade on an exchange and therefore are not included within available for sale securities. Also included in overseas deposits are restricted cash and cash equivalent balances held by Lloyd's syndicates for solvency purposes. Given the restricted nature of these cash balances, they are not included within the cash and cash equivalents category in the balance sheet.

**(c) Structured Transactions**

***Project Finance Loans***

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

At December 31, 2013 and 2012 the remaining structured project finance loans had an aggregate outstanding principal of \$15.2 million and \$36.8 million and an aggregate carrying value of \$11.1 million and \$31.2 million, respectively.

***National Indemnity Endorsement***

On June 9, 2009, XL Specialty Insurance Company ("XL Specialty"), a wholly-owned subsidiary of the Company, entered into an agreement with National Indemnity Company, an insurance company subsidiary of Berkshire Hathaway Inc. ("National Indemnity"). Under the agreement, and a related reinsurance agreement, National Indemnity would issue endorsements ("Endorsements") to certain directors and officers liability insurance policies known as "Side A" coverage policies underwritten by XL Specialty (the "Facility") during an eighteen month period that ended in December 31, 2011.

In connection with the Facility, the Company purchased a payment obligation (the "Obligation") in an aggregate principal amount of \$150 million from National Indemnity. The outstanding Obligation was recorded in Other Investments at an estimated fair value of \$128.1 million, pays a coupon of 3.5%, and is being accreted to \$150 million over the 11.5 year term of the payment obligation. The difference between the estimated fair value of the Obligation and the cost of that Obligation at the time of the transaction was approximately \$21.9 million and was recorded in Other Assets. This difference, together with fees of \$2.5 million, was amortized in relation to the earning of the underlying policies written. During the years ended December 31, 2013 and 2012, amortization of nil million, respectively, was recorded.

***Other Structured Transactions***

On July 17, 2009, the Company purchased notes with an aggregate face amount of \$155 million. The carrying value of these notes at December 31, 2013 and 2012 was \$148.0 million and \$147.8 million, respectively. The issuer of the notes is a structured credit vehicle that holds underlying assets including corporate debt and preferred equity securities, including some securities issued by European financial institutions, as well as project finance debt securities. The notes, which are callable under certain criteria, have a final maturity of July 22, 2039.

These structured transactions are not considered to be fair value measurements under U.S. GAAP and, accordingly, they have been excluded from the fair value measurement disclosures. See Note 3, "Fair Value Measurements," for details surrounding the estimated fair value of these investments.

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**6. Other Investments**

**(d) Other**

The Company regularly reviews the performance of these other investments. The Company recorded losses of \$nil and \$2.7 million in the years ended December 31, 2013 and 2012, respectively, due to other than temporary declines in values of these other investments.

See Note 15 (b), “Commitments and Contingencies – Other Investments,” for further information regarding commitments related to other investments.

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**7. Goodwill and Other Intangible Assets**

The following table presents an analysis of intangible assets broken down between goodwill, intangible assets with an indefinite life and intangible assets with a definite life for the years ended December 31, 2013 and 2012:

<i>(U.S. dollars in thousands)</i>	<b>Goodwill</b>	<b>Intangible assets with an indefinite life</b>	<b>Intangible assets with a definite life</b>	<b>Total</b>
Balance at December 31, 2011 .....	\$ 255,465	\$ 15,366	\$ 458	\$ 271,289
Impairment .....	-	-	-	-
Amortization .....	-	-	(178)	(178)
Foreign Currency Translation .....	1,383	-	-	1,383
Balance at December 31, 2012 .....	\$ 256,848	\$ 15,366	\$ 280	\$ 272,494
Amortization .....	-	-	(280)	(280)
Foreign Currency Translation .....	3,363	-	-	3,363
Balance at December 31, 2013 .....	<u>\$ 260,211</u>	<u>\$ 15,366</u>	<u>\$ -</u>	<u>\$ 275,577</u>

The Company has goodwill of \$260.2 million at December 31, 2013, all related to the Reinsurance segment. The estimated fair values of the reporting units' carrying goodwill exceeded their estimated net book values at December 31, 2013 and therefore no impairments were recorded during 2013. At December 31, 2013 and 2012, the ending goodwill balance is comprised of gross goodwill of \$0.7 billion, offset by accumulated impairment charges of \$0.4 billion.

The Company tests goodwill for impairment on an annual basis as of June 30, during the third quarter, and on an interim basis when certain events or circumstances exist. The Company tests for impairment at the reporting unit level in accordance with the authoritative guidance on intangibles and goodwill. For the Reinsurance segment, a reporting unit is one level below the business segment, while for Insurance, the segment is also the reporting unit. The first step is to identify potential impairment by comparing the estimated fair value of a reporting unit to its 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 and this is then compared to the book value of the business. 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. The estimated fair values of the reporting units are generally determined utilizing methodologies that incorporate price-to-net-tangible-book and price-to-earnings multiples of certain comparable companies in the industry, from an operational and economic standpoint. If such individual reporting unit estimated fair values - combined with an estimate of an appropriate control premium - exceed their related individual reporting unit net book values, goodwill for those individual reporting units is not deemed to be impaired. A control premium represents the value an investor would pay above non-controlling interest transaction prices in order to obtain a controlling interest in the respective company.

However, if the margin calculated between the estimated reporting unit fair value and its net book value indicates a potential impairment or a "close call", a further analysis of the reporting unit's estimated fair value is performed, using an entity-specific discounted cash flow methodology. This methodology establishes fair value by estimating the present value of the projected future cash flows to be generated from the reporting unit. The discount rate applied to the projected future cash flows to arrive at the present value is intended to reflect all risks of ownership and the associated risks of realizing the stream of projected future cash flows. The discounted cash flow methodology uses the Company's projections of financial performance for a ten-year period combined with an estimated terminal value. The most significant assumptions used in the discounted cash flow methodology are the discount rate, the terminal value and expected future revenues, gross margins and operating margins, which vary among reporting units. If the individual reporting unit net book values exceed their related individual reporting unit estimated fair values based on this additional methodology, the second step of the goodwill impairment testing process is performed to measure the amount of impairment.

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**8. Reinsurance**

The Company utilizes reinsurance and retrocession agreements principally to increase aggregate capacity and to reduce the risk of loss on business assumed. The Company's reinsurance and retrocession agreements provide for recovery of a portion of losses and loss expenses from reinsurers and reinsurance recoverables are recorded as assets. The Company is liable if the reinsurers are unable to satisfy their obligations under the agreements. Under its reinsurance security policy, the Company seeks to cede business to reinsurers generally with a financial strength rating of "A" or better. The Company considers reinsurers that are not rated or do not fall within the above rating categories and may grant exceptions to the Company's general policy on a case-by-case basis. The effect of reinsurance and retrocessional activity on premiums written and earned from property and casualty operations is shown below:

	Premiums Written		Premiums Earned	
	Year Ended December 31,		Year Ended December 31,	
(U.S. dollars in thousands)	2013	2012	2013	2012
Direct .....	\$ 5,050,953	\$ 4,733,516	\$ 4,966,207	\$ 4,604,323
Assumed .....	2,365,839	2,441,612	2,363,261	2,393,490
Ceded .....	(1,512,810)	(1,218,109)	(1,315,369)	(1,231,835)
Net.....	<u>\$ 5,903,982</u>	<u>\$ 5,957,019</u>	<u>\$ 6,014,099</u>	<u>\$ 5,765,978</u>

The Company recorded reinsurance recoveries on losses and loss expenses incurred of \$0.7 billion and \$0.6 billion for the years ended December 31, 2013 and 2012, respectively.

The following table presents an analysis of total unpaid losses and loss expenses and future policy benefit reserves recoverable for the year ended December 31:

(U.S. dollars in thousands)	2013	2012
P&C operations .....	\$ 3,414,735	\$ 3,361,702
Life Operations .....	20,495	20,399
Total unpaid losses and loss expenses recoverable .....	<u>\$ 3,435,230</u>	<u>\$ 3,382,101</u>

At December 31, 2013 and 2012, the total reinsurance assets of \$3.6 billion and \$3.4 billion, respectively, included reinsurance receivables for paid losses and loss expenses of \$118.9 million and \$58.4 million, respectively, with \$3.4 billion and \$3.4 billion relating to the ceded reserve for losses and loss expenses, including ceded losses incurred but not reported for each year end. Although the contractual obligation of individual reinsurers to pay their reinsurance obligations is based on specific contract provisions, the collectability of such amounts requires significant estimation by management. The majority of the balance the Company has accrued as recoverable will not be due for collection until sometime in the future. Over this period of time, economic conditions and operational performance of a particular reinsurer may impact its ability to meet these obligations and while it may continue to acknowledge its contractual obligation to do so, it may not have the financial resources or willingness to fully meet its obligations to the Company.

At December 31, 2013 and 2012, the allowance for uncollectible reinsurance relating to both reinsurance balances receivable and unpaid losses and loss expenses recoverable were \$85.5 million and \$107.9 million, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. As part of this process, ceded IBNR is allocated by reinsurer. The allocations are generally based on historical relationships between gross and ceded losses. If actual experience varies materially from historical experience, the allocation of reinsurance recoverable by reinsurer will change.

The Company uses a default analysis to estimate uncollectible reinsurance recoverables. The primary components of the default analysis are reinsurance recoverable balances by reinsurer, net of collateral, 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. The Company is the beneficiary of letters of credit, trust accounts and funds withheld in the aggregate amount of \$1.8 billion and \$1.7 billion at December 31, 2013 and 2012, respectively, collateralizing reinsurance recoverables with respect to certain reinsurers. Default factors require considerable judgment and are determined using the current financial strength rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions. The total allowance recorded relating to reinsurance recoverables was \$41.4 million and \$53.3 million at December 31, 2013 and 2012, respectively.

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**8. Reinsurance**

The Company uses an aging analysis to estimate uncollectible reinsurance balances receivable relating to paid losses in addition to recording allowances relating to any specific balances with known collectability issues, irrespective of aging. The balances are aged from the date the expected recovery was billed to the reinsurer. Provisions are applied at specified percentages of the outstanding balances based upon the aging profile. Allowances otherwise required as a result of the aging process may not be recorded to the extent that specific facts and circumstances exist that lead management to believe that amounts will ultimately be collectible. The total allowance recorded relating to reinsurance balances receivable was \$44.2 million and \$54.6 million at December 31, 2013 and 2012, respectively.

At December 31, 2013, the use of different assumptions within the model could have a material effect on the bad debt provision reflected in the Company's Consolidated Financial Statements. To the extent the creditworthiness of the Company's reinsurers was to deteriorate due to an adverse event affecting the reinsurance industry, such as a large number of major catastrophes, actual uncollectible amounts could be significantly greater than the Company's bad debt provision. Such an event could have a material adverse effect on the Company's financial condition, results of operations, and cash flows.

At December 31, 2013 and 2012, approximately 91% of the total unpaid loss and loss expense recoverable and reinsurance balances receivable (net of collateral held) outstanding was due from reinsurers with a financial strength rating of "A" or better. The following is an analysis of the total recoverable and reinsurance balances receivable at December 31, 2013, by reinsurers owing 3% or more of such total:

<b>Name of Reinsurer</b>	<b>Reinsurer Financial Strength Rating</b>	<b>% of Total</b>
Munich Reinsurance Company .....	AA-/Stable	26.9%
Swiss Reinsurance Company .....	AA-/Stable	10.5%
Lloyd's Syndicate .....	A+/Stable	6.1%
Swiss Re Europe S.A. ....	AA-/Stable	5.0%
Transatlantic Reinsurance Company .....	A+/Stable	4.7%

The following table sets forth the ratings profile of the reinsurers that support the unpaid loss and loss expense recoverable and reinsurance balances receivable:

<b>Reinsurer Financial Strength Rating</b>	<b>% of Total</b>
AAA.....	0.8%
AA.....	53.5%
A .....	36.7%
BBB .....	1.7%
BB and below.....	0.0%
Captives .....	5.2%
Not Rated .....	0.1%
Other .....	2.0%
Total.....	100.0%

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**9. Losses and Loss Expenses**

Unpaid losses and loss expenses for the indicated years ended December 31 are comprised of:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Reserve for reported losses and loss expenses .....	\$ 8,149,501	\$ 7,976,121
Reserve for losses incurred but not reported .....	12,331,564	12,508,000
Unpaid losses and loss expenses .....	<u>\$ 20,481,065</u>	<u>\$ 20,484,121</u>

Net losses and loss expenses incurred for the years indicated are comprised of:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Loss and loss expenses payments .....	\$ 4,496,802	\$ 4,673,997
Change in unpaid losses and loss expenses .....	(71,901)	(297,660)
Change in unpaid losses and loss expenses recoverable .....	(24,774)	279,900
Paid loss recoveries .....	(668,663)	(890,755)
Net losses and loss expenses incurred .....	<u>\$ 3,731,464</u>	<u>\$ 3,765,482</u>

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

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Unpaid losses and loss expenses at the beginning of the year .....	\$ 20,484,121	\$ 20,613,901
Unpaid losses and loss expenses recoverable .....	3,361,703	3,629,940
Net unpaid losses and loss expenses at the beginning of the year .....	\$ 17,122,418	\$ 16,983,961
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in: .....		
Current year .....	4,021,353	4,081,376
Prior year .....	(289,889)	(315,894)
Total net incurred losses and loss expenses .....	\$ 3,731,464	\$ 3,765,482
Exchange rate effects .....	40,587	156,217
Less net losses and loss expenses paid in respect of losses occurring in: .....		
Current year .....	425,254	416,844
Prior year .....	3,402,885	3,366,398
Total net paid losses .....	\$ 3,828,139	\$ 3,783,242
Net unpaid losses and loss expenses at the end of the year .....	17,066,330	17,122,418
Unpaid losses and loss expenses recoverable .....	3,414,735	3,361,703
Unpaid losses and loss expenses at the end of the year .....	<u>\$ 20,481,065</u>	<u>\$ 20,484,121</u>

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**9. Losses and Loss Expenses**

**(a) Prior year net losses incurred**

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 by operating segment for each of the years indicated:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Insurance segment.....	\$ (102,039)	\$ (140,066)
Reinsurance segment .....	(187,850)	(175,828)
Total.....	<u>\$ (289,889)</u>	<u>\$ (315,894)</u>

The significant developments in prior year loss reserve estimates for each of the years indicated within the Company's Insurance and Reinsurance segments are discussed below.

***Insurance Segment***

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

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Property.....	\$ (46,387)	\$ (46,735)
Casualty .....	(21,983)	(61,133)
Professional.....	75,045	(106,360)
Specialty .....	(140,740)	(61,755)
Other .....	32,026	135,917
Total.....	<u>\$ (102,039)</u>	<u>\$ (140,066)</u>

Net favorable prior year reserve development for the Insurance Segment of \$102.0 million for the year ended December 31, 2013 was mainly attributable to the following:

- For property lines, net prior year development during the year was \$46.4 million favorable. This was driven by better than expected loss experience reported for non-catastrophe exposures primarily in the 2012 accident year. It was also driven by a reduction of \$16.7 million in prior year catastrophe losses predominantly in the 2011 and 2012 accident years
- For casualty, net prior year development was \$22.0 million favorable. This was driven by a release of \$44.9 million in the excess casualty book mainly as a result of reflecting the better than expected loss experience reported across the 2006 and prior accident years. This was partially offset by adverse development of \$13.5 million in the U.S. environmental book primarily attributable to the 2010 accident year. In addition, worse than expected loss experience reported in the Lloyd's middle market book led to a deterioration of \$12.2 million principally in the 2010 to 2012 accident years.
- For professional, net prior year development was \$75.0 million unfavorable. This was driven by worse than expected loss experience reported in the core U.S. and international books across the 2009 to 2012 accident years.
- For specialty, net prior year development was \$140.7 million favorable. This was driven by releases of \$80.4 million, \$20.6 million and \$19.1 million for aerospace, marine and specie, respectively, due primarily to reflecting the better than expected loss experience reported predominantly across the 2005 and later accident years. It was also driven by a reduction of \$17.3 million in the Bermuda discontinued political risk book as a result of a review of the open claims and remaining exposure.
- Other net prior year development was \$32.0 million unfavorable. This was driven by deteriorations in the discontinued environmental book across the 2006 and prior accident years, strengthening of \$10.0 million in the 2006 accident year for the discontinued surety book, and an increase of \$5.9 million in the uncollectible reinsurance reserve from the Bermuda operations.

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Net favorable prior year reserve development of \$140.1 million for the year ended December 31, 2012 was attributable to releases of \$106.4 million in professional, \$61.8 million in specialty, \$61.1 million in casualty and \$46.7 million in property, partially offset by strengthening of \$135.9 million in other. Professional benefited from releases in reserves for clash losses (which cover a number of substantially similar claims against multiple policyholders) totaling \$120.8 million, partially offset by worse than expected loss experience reported in the design portfolio. Better than expected loss experience reported for the non-catastrophe exposures in the aerospace, specie, product recall and Lloyd's discontinued political risk books led to the release in specialty, while property benefited from favorable reported loss activity for both the catastrophe and non-catastrophe exposures. The release in casualty was mainly related to better than expected loss experience reported in both the primary and excess books, partially offset by adverse development in U.S. middle markets. Continued worse than expected loss experience reported in the excess and surplus lines, and adverse development in the programs and discontinued surety books drove the strengthening in other lines.

There is no assurance that conditions and trends that have affected the development of liabilities in the past will continue. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on the Company's historical results.

***Reinsurance Segment***

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

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Property and other short-tail lines .....	\$ (136,912)	\$ (107,613)
Casualty and other .....	(50,938)	(68,215)
Total .....	<u>\$ (187,850)</u>	<u>\$ (175,828)</u>

Net favorable prior year reserve development for the Reinsurance segment of \$187.9 million for the year ended December 31, 2013 was mainly attributable to the following:

- Net favorable prior year development for the short-tailed lines totaled \$136.9 million and details of the significant components are as follows:
  - For property catastrophe lines, net prior year development was \$60.0 million favorable comprised of a \$28.6 million release on attritional losses and \$31.5 million favorable development on major catastrophe losses mainly driven by a review of reserves for the 2005 hurricanes as well as the 2009 and prior years' typhoon and windstorm losses.
  - For property other lines, net prior year development was \$57.3 million favorable comprised of \$27.9 million favorable development for catastrophe and large losses and \$29.4 million favorable development due to better than expected attritional loss development. The notable favorable developments on prior year catastrophe losses include \$15.0 million for 2010 events and \$4.5 million for 2008 events.
  - For marine and aviation lines, net prior year development was \$19.6 million favorable driven by better than expected attritional loss development in the Europe marine book.
- Net favorable prior year development for the long-tailed lines totaled \$50.9 million and details of the significant components are as follows:
  - For casualty lines, net prior year development was \$72.2 million favorable due to better than expected development on attritional losses mainly driven by \$58.1 million from the North America book on underwriting years 2004-06 and \$14.4 million from the Europe book on underwriting years 2005-07.
  - For other lines, net prior year development was \$21.3 million unfavorable mainly driven by adverse development on surety losses in Europe.



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Net favorable prior year reserve development of \$175.8 million for the year ended December 31, 2012 was attributable to releases of \$107.6 million for the short-tailed lines and \$68.2 million for the long-tailed lines. The short-tailed lines benefited from \$16.5 million in favorable property catastrophe development, \$49.0 million in favorable property other lines releases and \$42.2 million in favorable marine and aviation development. The release in long-tailed lines was due to \$60.3 million in favorable casualty development and an additional \$7.9 million in favorable other lines development mainly driven by \$8.4 million release on the Structured Indemnity book.

There is no assurance that conditions and trends that have affected the development of liabilities in the past will continue. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on the Company's historical results.

**(b) Loss Reserve discounting**

Except for certain workers' compensation (including long term disability) liabilities and certain bodily injury liability claims, emanating from U.K. exposures, predominantly from the U.K. motor liability portfolio, the Company does not discount its unpaid losses and loss expenses.

The Company utilizes tabular reserving for workers' compensation (including long-term disability) unpaid losses that are considered fixed and determinable, and discounted such losses using an interest rate of 5% in 2013 and 2012. The interest rate approximates the average yield to maturity on specific fixed income investments that support these liabilities. The tabular reserving methodology 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, 2013 and 2012 on an undiscounted basis were \$609.1 million and \$645.2 million, respectively. The related discounted unpaid losses and loss expenses were \$331.5 million and \$343.0 million at December 31, 2013 and 2012, respectively.

The Company records specific reserve allowance for Periodical Payment Orders ("PPO") related to bodily injury liability claims. This allowance includes the unpaid losses for claims already settled and notified as PPO at December 31, 2013, as well as the unpaid losses for claims to be settled in the future. The future care element of the unpaid losses was discounted using an interest rate of 1.5% at both December 31, 2013 and 2012. Unpaid losses and loss expenses, net of reinsurance, at December 31, 2013 and 2012 on an undiscounted basis were \$262.0 million and \$240.0 million, respectively. After discounting the future care element, the unpaid losses and loss expenses were \$165.7 million and \$148.6 million at December 31, 2013 and 2012, respectively. The increase in net undiscounted unpaid losses and loss expenses between December 31, 2012 and December 31, 2013 is mainly due to foreign exchange rate movements.

The nature of the Company's high excess of loss liability and catastrophe business can result in loss events 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. Conditions and trends that have affected development of liability in the past may not continue in the future. Accordingly, it is inappropriate to extrapolate future redundancies or deficiencies based upon historical experience.

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**9. Losses and Loss Expenses**

**(c) Discontinued Asbestos and Run-Off Environmental Related Claims**

The Company's reserving process includes a continuing evaluation of the potential impact on unpaid liabilities from exposure to discontinued asbestos and run-off environmental claims, including related loss adjustment expenses. Liabilities are established to cover both known and incurred but not reported claims. The Company's reserving and exposures to environmental liability business currently written within the NAPC and IPC business groups are not included in this note, which only relates to specific discontinued and/or run-off coverages, not originally written specifically to cover such environmental hazards.

The Company's exposure to discontinued asbestos and run-off environmental claims arises from the following three sources:

- (1) Reinsurance contracts written, both on a proportional and excess basis, after 1972. The Company discontinued writing contracts with these exposures in 1985. Business written was across many different policies, each with a relatively small contract limit. The Company's reported asbestos claims relate to both traditional products and premises and operations coverage.
- (2) Winterthur – business of Winterthur purchased by the Company from AXA Insurance (formerly Winterthur Swiss Insurance Company) in 2001. Pursuant to the Sale and Purchase Agreement and related agreements, AXA Insurance reimburses the Company for all asbestos losses.
- (3) During 2006, the Company acquired \$40.2 million in losses through a loss portfolio transfer contract of which \$18.3 million in losses related to asbestos and environmental claims. Given the terms of the policy, the combined aggregate limit on the total acquired reserves is limited to \$60.0 million, not including coverage for claims handling costs over a defined period.

A reconciliation of the opening and closing unpaid losses and loss expenses related to discontinued asbestos and run-off environmental exposure claims for the years indicated is as follows:

**Year ended December 31,**  
*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Net unpaid losses and loss expenses at beginning of year .....	\$ 78,315	\$ 77,778
Net incurred losses and loss expenses .....	6,257	6,558
Less net paid losses and loss expenses .....	4,137	6,021
Net increase (decrease) in unpaid losses and loss expenses .....	2,120	537
Net unpaid losses and loss expenses at end of year .....	80,435	78,315
Unpaid losses and loss expenses recoverable at end of year .....	115,090	123,799
Gross unpaid losses and loss expenses at end of year .....	<u>\$ 195,525</u>	<u>\$ 202,114</u>

Reserves for incurred but not reported losses, net of reinsurance, included in the above table were \$48.6 million and \$52.2 million in 2013 and 2012, respectively. Unpaid losses recoverable are net of potential uncollectible amounts.

At December 31, 2013, the Company had 1,097 open claim files for potential discontinued asbestos claims exposures and 338 open claim files for potential run-off environmental claims exposures. Approximately 37% and 42% of the open claim files are due to precautionary claim notices in 2013 and 2012, respectively. Precautionary claim notices are submitted by the ceding companies in order to preserve their right to receive coverage under the reinsurance contract.

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Such notices do not contain an incurred loss amount to the Company. The development of the number of open claim files for potential discontinued asbestos and run-off environmental claims, including precautionary claims, is as follows:

	<b>Asbestos Claims</b>	<b>Environmental Claims</b>
Total number of claims outstanding at December 31, 2011.....	1,038	362
New claims reported in 2012.....	236	60
Claims resolved in 2012.....	<u>(201)</u>	<u>(68)</u>
Total number of claims outstanding at December 31, 2012.....	1,073	354
New claims reported in 2013.....	178	34
Claims resolved in 2013.....	<u>(154)</u>	<u>(50)</u>
Total number of claims outstanding at December 31, 2013.....	<u>1,097</u>	<u>338</u>

The Company's reserving process includes a continuing evaluation of the potential impact on unpaid liabilities from exposure to discontinued asbestos and run-off environmental claims, including related loss adjustment expenses. Liabilities are established to cover both known and incurred but not reported claims.

The estimation of loss and loss expense liabilities for discontinued asbestos and run-off environmental exposures is subject to much greater uncertainty than is normally associated with the establishment of liabilities for certain other exposures due to several factors, including: (i) uncertain legal interpretation and application of insurance and reinsurance coverage and liability; (ii) the lack of reliability of available historical claims data as an indicator of future claims development; (iii) an uncertain political climate which may impact, among other areas, the nature and amount of costs for remediating waste sites; and (iv) the potential of insurers and reinsurers to reach agreements in order to avoid further significant legal costs. Due to the potential significance of these uncertainties, the Company believes that no meaningful range of loss and loss expense liabilities beyond recorded reserves can be established. As the Company's net unpaid loss and loss expense reserves related to discontinued asbestos and run-off environmental exposures are less than 1% of the total net reserves at December 31, 2013 and 2012, further adverse development is not expected to be material to the Company's overall net loss reserves. The Company believes it has made reasonable provision for its discontinued asbestos and run-off environmental exposures and is unaware of any specific issues that would significantly affect its estimate for loss and loss expenses.

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**10. Deposit Liabilities**

The Company has entered into certain insurance and reinsurance policies that transfer insufficient risk under GAAP to be accounted for as insurance or reinsurance transactions and are recognized as deposits. These structured property and casualty agreements have been recorded as deposit liabilities and are initially matched by an equivalent amount of investments. The Company has investment risk related to its ability to generate sufficient investment income to enable the total invested assets to cover the payment of the ultimate liability. See Note 4, "Investments," for further information relating to the Company's net investment income as well as realized and unrealized investment (losses) gains. 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. Deposit liabilities are initially recorded at an amount equal to the assets received.

Total deposit liabilities were \$1.5 billion and \$1.6 billion for the years ended December 31, 2013 and 2012, respectively. Interest expense of \$48.0 million and \$66.3 million was recorded related to the accretion of deposit liabilities for the years ended December 31, 2013 and 2012, respectively.

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**11. Future Policy Benefit Reserves**

Future policy benefit reserves are comprised of the following:

**Year ended December 31**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Traditional Life .....	827,341	805,558
Annuities .....	3,976,475	4,006,487
Total future policy benefit reserves .....	<u>4,803,816</u>	<u>4,812,045</u>

The Company entered into long duration contracts that subject the Company to mortality and morbidity risks and that were accounted for as life premiums earned. Future policy benefit reserves were established using appropriate assumptions for investment yields, mortality, and expenses, including a provision for adverse deviation. The average interest rate used for the determination of the future policy benefits for these contracts was 4.4% and 4.5% at December 31, 2013 and 2012, respectively. Total future policy benefit reserves for the year ended December 31, 2013 and 2012 were \$4.8 billion. The net decrease, during 2013, in the total future policy benefit reserves was from normal course releases on single premium annuities in line with the benefits paid and mortality of underlying policyholders, which has been partially offset by foreign exchange movements.

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**12. Notes Payable and Debt and Financing Arrangements**

At December 31, the Company's financing structure, which includes senior unsecured notes, bank and loan facilities available from a variety of sources, including commercial banks, and letter of credit facilities was as follows:

	2013		2012	
	Commitment/ Debt	In Use/ Outstanding (1)	Commitment/ Debt	In Use/ Outstanding (1)
<i>(U.S. dollars in thousands)</i>				
<b>Debt:</b>				
5-year revolver expiring 2018 .....	\$ 1,000,000	\$ -	\$ 1,000,000	\$ -
<b>Total debt</b> .....	<u>\$ 1,000,000</u>	<u>\$ -</u>	<u>\$ 1,000,000</u>	<u>\$ -</u>
<b>Carrying value</b> .....	<u>\$ 1,000,000</u>	<u>\$ -</u>	<u>\$ 1,000,000</u>	<u>\$ -</u>
<b>Letters of Credit:</b>				
7 facilities - total .....	<u>\$ 3,575,000</u>	<u>\$ 1,895,425</u>	<u>\$ 4,000,000</u>	<u>\$ 1,757,250</u>

(1) "In Use" and "Outstanding" data represent December 31, 2013 and 2012 accreted values.

**(a) Letter of Credit Facilities and Other Sources of Collateral**

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

	2013 (1)	2012 (1)
<i>(U.S. dollars in thousands)</i>		
Revolving credit facility (2) .....	\$ 1,000,000	\$ 1,000,000
Available letter of credit facilities - commitments (3) .....	\$ 3,575,000	\$ 4,000,000
Available letter of credit facilities - in use .....	\$ 1,895,425	\$ 1,757,250
Collateralized by certain assets of the Company's investment portfolio .....	67.6%	93.3%

- (1) At December 31, 2013, there were seven available letters of credit facilities; at December 31, 2012, there were five available letter of credit facilities.
- (2) At December 31, 2013 and 2012, the revolving credit available under the Syndicated Credit Agreements (as defined below) and under the December 9, 2011 unsecured credit agreement, respectively, was unutilized. The 2013 Citi Agreements (as defined below) provide for issuance of letters of credit and revolving credit loans up to an aggregate amount of \$575 million. At December 31, 2013, \$575 million of letters of credit were issued under the 2013 Citi Agreements and therefore such amount is not included here.
- (3) The Company has the option to increase the size of the facility under the Syndicated Credit Agreements by an additional \$500 million across such facilities. The Company also has the option to increase the maximum amount of the letters of credit and revolving credit loans available under the 2013 Citi Agreements, with the lender's and issuing lender's consent .

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**12. Notes Payable and Debt and Financing Arrangements**

In November 2013 the Company (i) entered into two new credit agreements (together, the "Syndicated Credit Agreements"), which provided for an aggregate amount of outstanding letters of credit and revolving credit loans of up to \$2 billion, subject to certain options to increase the size of the facilities, and (ii) terminated the secured credit agreements dated March 25, 2011 and December 9, 2011, and the unsecured credit agreement dated December 9, 2011, which had provided for an aggregate amount of outstanding letters of credit and revolving credit loans of up to \$3 billion.

The Syndicated Credit Agreements consist of (i) a secured credit agreement, which provides for issuance of letters of credit up to \$1 billion and (ii) an unsecured credit agreement, which provides for issuance of letters of credit and revolving credit loans up to \$1 billion. The Company has the option to increase the maximum amount of letters of credit available by an additional \$500 million across the facilities under the Syndicated Credit Agreements.

The commitments under the Syndicated Credit Agreements expire on, and such credit facilities are available until, the earlier of (i) November 22, 2018 and (ii) the date of termination in whole of the commitments upon an optional termination or reduction of the commitments by the account parties or upon the occurrence of certain events of default.

The availability of letters of credit under the secured portion of the Syndicated Credit Agreements is subject to a borrowing base requirement, determined on the basis of specified percentages of the face value of eligible categories of assets varying by type of collateral. 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 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.

On May 7, 2013, XLIT Ltd on behalf of XL Re Ltd entered into a new credit agreement with Citicorp USA, Inc., as administrative agent and issuing lender, and the lenders party thereto, and a continuing agreement for standby letters of credit with Citibank, N.A. On May 13, 2013 and May 15, 2013, XL-Cayman entered into a credit agreement first amendment and credit agreement second amendment, respectively, to such credit agreement (as amended, the "May 2013 Credit Agreement").

On August 6, 2013, XLIT Ltd on behalf of XL Life Ltd entered into a new credit agreement with Citicorp USA, Inc., as administrative agent and issuing lender, and the lenders party thereto and a continuing agreement for standby letters of credit with Citibank, N.A. On September 12, 2013, XL-Cayman entered into a credit agreement first amendment to such credit agreement (as amended, the "August 2013 Credit Agreement").

Additionally, on November 4, 2013, XLIT Ltd on behalf of XL Life Ltd entered into a new credit agreement with Citicorp USA, Inc., as administrative agent and issuing lender, and the lenders party thereto and a continuing agreement for standby letters of credit with Citibank, N.A. (the "November 2013 Credit Agreement" and, together with the May 2013 Credit Agreement and the August 2013 Credit Agreement, the "2013 Citi Agreements").

Collectively, the 2013 Citi Agreements and the continuing agreements for standby letters of credit provide for issuance of letters of credit and revolving credit loans in an aggregate amount of up to \$575 million. XLIT Ltd has the option to increase the maximum amount of letters of credit and revolving credit loans available under the 2013 Citi Agreements with the lender's and issuing lender's consent.

The commitments under the 2013 Citi Agreements expire on, and such credit facilities are available until, the earlier of (i) June 20, 2015 (with respect to the May 2013 Credit Agreement), September 20, 2015 (with respect to the August 2013 Credit Agreement) and December 20, 2016 (with respect to the November 2013 Credit Agreement) and (ii) the date of termination in whole of the commitments upon an optional termination or reduction of the commitments by the account parties or upon the occurrence of certain events of default.

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In addition to letters of credit, the Company has established insurance trusts in the U.S. that provide cedants with statutory relief required under state insurance regulation in the U.S. It is anticipated that the commercial facilities may be renewed on expiry but such renewals are subject to the availability of credit from banks utilized by the Company and may be renewed with materially different terms and conditions. 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 additional insurance trusts supported by the Company's investment portfolio or funds withheld using the Company's cash resources. The value 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 general, all of the Company's bank facilities, indentures and other documents relating to the Company's outstanding indebtedness (collectively, the "Company's Debt Documents"), as described above, contain cross acceleration or 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 a maximum level of secured indebtedness that may be incurred 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. The Company's credit facilities also contain minimum consolidated net worth covenants.

Under the Syndicated Credit Agreements, in the event that XL Insurance (Bermuda) Ltd, XL Re Ltd or XL Re Europe SE fails to maintain a financial strength rating of at least "A-" from A.M. Best, an event of default would occur.

Given that all of the Company's Debt Documents contain cross acceleration or cross default provisions, a default by one of these companies may result in all holders declaring their debt due and payable and accelerating 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.



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**13. Derivative Instruments**

The Company enters into derivative instruments for both risk management and investment purposes. The Company is exposed to potential loss from various market risks, and manages its market risks based on guidelines established by management and the Risk and Finance Committee of the Company's Board of Directors. The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value with the changes in fair value of derivatives shown in the consolidated statement of income as "net realized and unrealized gains and losses on derivative instruments" unless the derivatives are designated as hedging instruments. The accounting for derivatives that are designated as hedging instruments is described in Note 2(h), "Significant Accounting Policies – Derivative Instruments." The following table summarizes information on the location and gross amounts of derivative fair values contained in the consolidated balance sheet as at December 31, 2013 and 2012:

	December 31, 2013				December 31, 2012			
	Asset Derivative Notional Amount	Asset Derivative Fair Value (1)	Liability Derivative Notional Amount	Liability Derivative Fair Value (1)	Asset Derivative Notional Amount	Asset Derivative Fair Value (1)	Liability Derivative Notional Amount	Liability Derivative Fair Value (1)
<i>(U.S. dollars in thousands)</i>								
Derivatives designated as hedging instruments:								
Foreign exchange contracts .....	\$ 1,005,610	\$ 26,098	\$ 2,572,227	\$ 70,462	\$ 670,751	\$ 12,511	\$ 2,382,507	\$ 23,715
Total derivatives designated as hedging instruments.....	<u>\$ 1,005,610</u>	<u>\$ 26,098</u>	<u>\$ 2,572,227</u>	<u>\$ 70,462</u>	<u>\$ 670,751</u>	<u>\$ 12,511</u>	<u>\$ 2,382,507</u>	<u>\$ 23,715</u>
Derivatives not designated as hedging instruments:								
<i>Investment Related Derivatives:</i>								
Interest rate exposure .....	\$ 30,702	\$ 266	\$ 10,259	\$ 8	\$ 45,604	\$ 2,060	\$ 26,139	\$ 253
Foreign exchange exposure .....	17,497	12	50,614	680	33,007	226	54,449	1,790
Credit exposure .....	-	-	340,020	15,128	25,000	486	436,959	15,472
Financial market exposure .....	58,232	1,111	14,821	77	72,597	9,559	16,910	-
<i>Financial Operations Derivatives: (2)</i>								
Credit exposure (2) .....	-	-	44,234	4,190	-	-	46,903	-
<i>Other Non-Investment Derivatives:</i>								
Guaranteed minimum income benefit contract .....	-	-	53,564	14,940	-	-	69,051	25,396
Modified coinsurance funds withheld contract .....	66,369	-	-	-	76,975	-	-	-
Total derivatives not designated as hedging instruments.....	<u>\$ 172,800</u>	<u>\$ 1,389</u>	<u>\$ 513,512</u>	<u>\$ 35,023</u>	<u>\$ 253,183</u>	<u>\$ 12,331</u>	<u>\$ 650,411</u>	<u>\$ 42,911</u>

- (1) Derivative instruments in an asset or liability position are included within Other assets or Other liabilities, respectively, in the balance sheet on a net basis where the Company has both a legal right of offset and the intentions to settle the contracts on a net basis.
- (2) Financial operations derivatives represent interests in variable interest entities as described in Note 14, "Variable Interest Entities."

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**13. Derivative Instruments**

The following table summarizes information on the gross and net amounts of derivative fair values and associated collateral received related to derivative assets or paid relating to derivative liabilities contained in the consolidated balance sheet at December 31, 2013 and 2012:

<b>December 31, 2013</b> <i>(U.S. dollars in thousands)</i>	<b>Gross Amounts Recognized in Balance Sheet</b>	<b>Gross Amounts Offset in the Balance Sheet</b>	<b>Net Amounts in the Balance Sheet</b>	<b>Gross Amounts Not Offset in the Balance Sheet</b>		<b>Net Amounts</b>
				<b>Financial Instruments</b>	<b>Cash Collateral</b>	
Derivative Assets	\$ 27,487	\$ 1,342	\$ 26,145	\$ —	\$ —	\$ 26,145
Derivative Liabilities	\$ 105,485	\$ 1,342	\$ 104,143	\$ —	\$ 19,847	\$ 84,296
<b>December 31, 2012</b> <i>(U.S. dollars in thousands)</i>						
Derivative Assets	\$ 24,842	\$ 1,327	\$ 23,515	\$ —	\$ —	\$ 23,515
Derivative Liabilities	\$ 66,626	\$ 1,327	\$ 65,299	\$ —	\$ 12,130	\$ 53,169

Derivative instruments in an asset or liability position are included within Other assets or Other liabilities, respectively, in the balance sheet on a net basis where the Company has both a legal right of offset and the intentions to settle the contracts on a net basis. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under netting agreements. At December 31, 2013 and 2012, the Company paid cash collateral related to foreign currency derivative positions and certain other derivative positions of \$19.8 million and \$12.1 million, respectively. The assets related to the net collateral paid were recorded as Other assets within the balance sheet as the collateral and derivative positions are not intended to be settled on a net basis.

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**13. Derivative Instruments**

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

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

The Company may hedge portions of its liabilities against changes in the applicable designated benchmark interest rate. Interest rate swaps may also be used to hedge the changes in fair value of certain fixed rate liabilities and fixed income securities due to changes in the designated benchmark interest rate. In addition, the Company utilizes foreign exchange contracts to hedge the fair value of certain fixed income securities as well as to hedge certain net investments in foreign operations.

The following table provides the total impact on earnings relating to derivative instruments formally designated as fair value hedges along with the impacts of the related hedged items for the years ended December 31, 2013 and 2012:

	Hedged Items - Amount of Gain/(Loss) Recognized in Income Attributable to Risk					Ineffective Portion of Hedging Relationship - Gain/(Loss)
Derivatives Designated as Fair Value Hedges: (U.S. dollars in thousands)	Gain/(Loss) Recognized in Income on Derivative	Deposit Liabilities	Fixed Maturity Investments	Notes Payable and Debt		
Year Ended December 31, 2013						
Interest rate exposure .....	\$ -					
Foreign exchange exposure.....	(22,568)					
Total.....	\$ (22,568)	\$ -	\$ 23,065	\$ -	\$ 497	
Year Ended December 31, 2012						
Interest rate exposure .....	\$ 1,813					
Foreign exchange exposure.....	(24,183)					
Total.....	\$ (22,370)	\$ (6,182)	\$ 23,967	\$ -	\$ (4,585)	

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

The periodic coupon settlements also resulted in decreases to Interest expense of \$nil and \$4.9 million for the years ended December 31, 2013 and 2012.

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**13. Derivative Instruments**

***Settlement of Fair Value Hedges***

A summary of the fair value hedges that have been settled and their impact on results during the year ended December 31, 2013 and 2012, as well as the remaining balance of fair value hedges and average years remaining to maturity are shown below:

<b>Settlement of Fair Value Hedges - Summary</b> <i>(U.S. dollars in thousands, except years)</i>	<b>Fair Value Hedges - Notes Payable and Debt</b> <b>December 31,</b>		<b>Fair Value Hedges - Deposit Liabilities</b> <b>December 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Cumulative reduction to interest expense .....	\$ 18,856	\$ 14,949	\$ 37,382	\$ 21,395
Remaining balance.....	\$ 2,768	\$ 6,675	\$ 195,814	\$ 211,800
Weighted average years remaining to maturity.....	0.7	1.7	22.7	25.3

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

The Company utilizes foreign exchange contracts to hedge the fair value of certain net investments in foreign operations. During the year ended December 31, 2013 and 2012, the Company entered into foreign exchange contracts that were formally designated as hedges of investments in foreign subsidiaries, the majority of which have functional currencies of either U.K. sterling or the Euro. There was no ineffectiveness in these transactions.

The following table provides the weighted average U.S. dollar equivalent of foreign denominated net assets that were hedged and the resultant gain (loss) that was recorded in the cumulative translation adjustment account within AOCI for the year ended December 31, 2013 and 2012.

**Derivative Instruments Designated as Hedges of the Net Investment in a Foreign Operation - Summary**

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Weighted average of U.S. dollar equivalent of foreign denominated net assets .....	\$ 2,648,137	\$ 1,962,076
Derivative gains (losses) (1) .....	\$ (27,392)	\$ (36,649)

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

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**13. Derivative Instruments**

**(c) Derivative Instruments Not Formally Designated As Hedging Instruments**

The following table provides the total impact on earnings relating to derivative instruments not formally designated as hedging instruments under authoritative accounting guidance and from the ineffective portion of fair value hedges. The impacts are all recorded through Net realized and unrealized gains (losses) on derivatives in the income statement for the years ended December 31, 2013 and 2012:

**Net Realized and Unrealized Gains (Losses)  
on Derivative Instruments**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Investment Related Derivatives:		
Interest rate exposure .....	\$ 5,065	\$ 4,394
Foreign exchange exposure .....	(948)	(1,059)
Credit exposure .....	(4,052)	(7,611)
Financial market exposure .....	6,301	3,073
Financial Operations Derivatives:		
Credit exposure .....	(2,437)	10,511
Other Non-Investment Derivatives:		
Guaranteed minimum income benefit contract .....	10,457	(2,906)
Modified coinsurance funds withheld contract .....	(7,086)	3,429
Total derivatives not designated as hedging instruments .....	\$ 7,300	\$ 9,831
Amount of gain (loss) recognized in income from ineffective portion of fair value hedges .....	497	(4,585)
Net realized and unrealized gains (losses) on derivative instruments .....	<u>\$ 7,797</u>	<u>\$ 5,246</u>

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

**(d)(i) Investment Related Derivatives**

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

***Investment Related Derivatives – Interest Rate Exposure***

The Company utilizes risk management and overlay strategies that incorporate the use of derivative financial instruments, primarily to manage its fixed income portfolio duration and net economic exposure to interest rate risks. The Company also uses interest rate swaps to convert certain liabilities from a fixed rate to a variable rate of interest and may also use them to convert a variable rate of interest from one basis to another.

***Investment Related Derivatives – Foreign Exchange Exposure***

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

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**13. Derivative Instruments**

In addition, certain of the Company's investment managers may, subject to investment guidelines, enter into forward contracts.

***Investment Related Derivatives – Credit Exposure***

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

***Investment Related Derivatives – Financial Market Exposure***

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

**(d)(ii) Financial Operations Derivatives – Credit Exposure**

At December 31, 2013 and 2012, the Company held one credit derivative exposure, which was written as part of the Company's previous financial lines business and is outside of the Company's investment portfolio. This is a European project finance loan participation that benefits from a deficiency guarantee from the German state and federal governments in the current amount of 68% following the scheduled expiry of a portion of this guarantee (80% at December 31, 2012). An aggregate summary of the credit derivative exposure at December 31 for the years indicated is as follows:

**Financial Operations Derivatives - Credit Exposure Summary:**

*(U.S. dollars in thousands, except term to maturity)*

	<b>2013</b>	<b>2012</b>
Principal outstanding .....	\$ 42,080	\$ 44,281
Interest outstanding .....	2,154	2,622
Aggregate outstanding exposure .....	<u>\$ 44,234</u>	<u>\$ 46,903</u>
Total liability recorded .....	\$ 4,190	\$ -
Weighted average contractual term to maturity .....	3.7 years	4.7 years
Underlying obligations credit rating .....	CC	BB

At December 31, 2013 and 2012, there was no reported event of default on this obligation; however, due to the combination of the reduction in the deficiency guarantee percentage and a deterioration of the credit rating of the underlying obligations, a liability of \$4.2 million was recorded during the year ended December 31, 2013. Credit derivatives are recorded at fair value based upon prices received from the investment bank counterparties and corroborated by using models developed by the Company. Although the Company does not have access to the specific unobservable inputs that may have been used in the value provided by the counterparty, it expects that the significant inputs considered would include changes in interest rates, future default rates, credit spreads, changes in credit quality, future expected recovery rates and other market factors. The change resulting from movements in credit and credit quality spreads is unrealized as the credit derivative is not traded to realize this resultant value.

**(d)(iii) Other Non-Investment Derivatives**

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

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**13. Derivative Instruments**

**(e) Contingent Credit Features**

Certain derivatives agreements entered into by the Company or its subsidiaries contain rating downgrade provisions that permit early termination of the agreement by the counterparty if collateral is not posted following failure to maintain certain credit ratings from one or more of the principal credit rating agencies. If the Company were required to early terminate such agreements due to a rating downgrade, it could potentially be in a net liability position at the time of settlement. The aggregate fair value of all derivatives agreements containing such rating downgrade provisions that were in a liability position and the collateral posted under any of these agreements as of December 31, 2013 and December 31, 2012 were as follows:

**Contingent Credit Features - Summary:**

*(U.S. dollars in thousands)*

	<u>2013</u>	<u>2012</u>
Aggregate fair value of derivative agreements with downgrade provisions in a net liability position ..\$	47,703	\$ 20,366
Collateral posted to counterparty .....	\$ 13,260	\$ 5,490

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**14. Variable Interest Entities**

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

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

The Company has a limited number of remaining outstanding credit enhancement exposures, including written financial guarantee and credit default swap contracts. The obligations related to these transactions are often securitized through VIEs. The Company is not the primary beneficiary of these VIEs as contemplated in current authoritative accounting guidance on the basis that management does not believe that the Company has the power to direct the activities, such as asset selection and collateral management, which most significantly impact each entity's economic performance. For further details on the nature of the obligations and the size of the Company's maximum exposure, see Note 13, "Derivative Instruments," and Note 15 (h), "Commitments and Contingencies – Financial and Other Guarantee Exposures."

During the third quarter of 2013, the Company, along with other investors, formed a new Bermuda-based company, New Ocean Capital Management Limited ("New Ocean"), to act as an investment manager that will focus on providing third-party investors access to insurance-linked securities and other insurance and reinsurance capital markets products. The Company holds a majority voting interest in New Ocean through its ownership of common shares and, accordingly, the financial statements of New Ocean have been included in the consolidated financial statements of the Company. None of the assets, liabilities, revenues or net income of New Ocean was material to the Company during the current year. The equity interest attributable to third party investors in New Ocean recorded in the Company's Consolidated Balance Sheet as "Non-controlling interest in equity of consolidated subsidiaries" was \$0.3 million at December 31, 2013.

During the fourth quarter of 2013, the Company, along with other investors, invested in a new Bermuda-based company, New Ocean Focus Cat Fund Ltd. ("New Ocean FCFL"), which is considered a VIE under GAAP. New Ocean FCFL will invest in a special purpose reinsurer formed for the purpose of underwriting collateralized excess of loss reinsurance with a focus on global property catastrophe risks. The Company currently holds a majority equity interest in New Ocean FCFL, which is considered to be the controlling interest in the VIE. Accordingly, included in the consolidated financial statements of the Company are New Ocean FCFL's total assets of \$23.5 million of cash. There were no liabilities, revenues or net income of New Ocean FCFL for the year ended December 31, 2013. The equity interest attributable to third party investors in New Ocean FCFL recorded in the Company's Consolidated Balance Sheet as "Non-controlling interest in equity of consolidated subsidiaries" was \$6.9 million at December 31, 2013.



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**15. Commitments and Contingencies**

**(a) Concentrations of Credit Risk**

The creditworthiness of any counterparty is evaluated by the Company, taking into account credit ratings assigned by rating agencies. The credit approval process involves an assessment of factors including, among others, the counterparty and country and industry credit exposure limits. Collateral may be required, at the discretion of the Company, on certain transactions based on the creditworthiness of the counterparty.

The areas where significant concentrations of credit risk may exist include unpaid losses and loss expenses recoverable and reinsurance balances receivable (collectively, “reinsurance assets”) and in the investment fixed income portfolio.

***Reinsurance Assets***

The Company’s reinsurance assets resulted from reinsurance arrangements in the course of its operations. A credit exposure exists with respect to reinsurance assets as they may be uncollectible. The Company manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound, and if necessary, the Company may hold collateral in the form of funds, trust accounts and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis. For further details regarding the Company’s reinsurance assets, see Note 8, “Reinsurance.”

***Fixed Income Portfolio***

The Company did not have an aggregate direct investment in any single corporate issuer in excess of 5% of shareholders’ equity at December 31, 2013 or December 31, 2012. Corporate issuers represent only direct exposure to fixed maturities and short-term investments of the parent issuer and its subsidiaries. These exposures exclude asset and mortgage back securities that were issued, sponsored or serviced by the parent and government-guaranteed issues, but does include covered bonds.

***Broker credit risk***

In addition, the Company underwrites a significant amount of its insurance and reinsurance property and casualty business through brokers and a credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of insurance and reinsurance balances to the Company. During the two years ended December 31, 2013 and 2012 P&C gross written premiums generated from or placed by the below companies individually accounted for more than 10% of the Company’s consolidated gross written premiums from P&C operations, as follows:

<i>(Percentage of consolidated gross written premiums from P&amp;C operations)</i>	<b>2013</b>	<b>2012</b>
AON Corporation and subsidiaries .....	21%	22%
Marsh & McLennan Companies .....	23%	21%
Willis Group and subsidiaries .....	13%	11%

These brokers are large, well established companies and there are no indications that any of them are financially troubled. No other broker and no one insured or reinsured accounted for more than 10% of gross premiums written from P&C operations in any of the two years ended December 31, 2013 and 2012.

**(b) Other Investments**

The Company has committed to invest in several limited partnerships and provide liquidity financing to a structured investment vehicle. At December 31, 2012, the Company has commitments, which include potential additional add-on clauses, to invest an additional \$184.8 million over a weighted average period of 5.4 years.

**(c) Investments in Affiliates**

The Company owns a minority interest in certain closed-end funds, certain limited partnerships and similar investment vehicles, including funds managed by those companies. The Company has commitments, which include potential additional add-on clauses, to invest an additional \$108.2 million over a weighted average period of 7.9 years.

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**15. Commitments and Contingencies**

**(d) Properties**

The Company rents space for certain of its offices under leases that expire up to 2031. Total rent expense under operating leases for the years ended December 31, 2013 and 2012 was approximately \$38.7 million and \$35.6 million, respectively. Future minimum rental commitments under existing operating leases are expected to be as follows:

**Year Ended December 31,**

*(U.S. dollars in thousands)*

2014 .....	37,095
2015 .....	34,554
2016 .....	28,410
2017 .....	23,623
2018 .....	19,133
2019-2031 .....	83,190
<b>Total minimum future rentals .....</b>	<b>\$ 226,005</b>

During 2003, the Company entered into a purchase, sale and leaseback transaction to acquire new office space in London. The Company has recognized a capital lease asset of \$94.4 million and \$98.5 million, and deferred a gain of \$28.7 million and \$29.9 million related to this lease at December 31, 2013 and 2012, respectively. The gain is being amortized to income in line with the amortization of the asset. The future minimum lease payments in the aggregate are expected to be \$215.5 million and annually for the next five years are as follows:

**Year Ended December 31,**

*(U.S. dollars in thousands)*

2014 .....	12,515
2015 .....	12,828
2016 .....	13,149
2017 .....	13,477
2018 .....	13,815
2019-2028 .....	149,686
<b>Total minimum future lease payments .....</b>	<b>\$ 215,470</b>

**(e) Tax Matters**

The Company is incorporated in Bermuda, except as described below, neither it nor its non-U.S. subsidiaries have paid U.S. corporate income taxes (other than withholding taxes on dividend income) on the basis that they are not engaged in a trade or business or otherwise subject to taxation in the United States. However, because definitive identification of activities which constitute being engaged in a trade or business in the United States is not provided by the Internal Revenue Code of 1986, regulations or court decisions, there can be no assurance that the Internal Revenue Service will not contend that the Company or its non-U.S. subsidiaries are engaged in a trade or business or otherwise subject to taxation in the United States. If the Company or its non-U.S. subsidiaries were considered to be engaged in a trade or business in the United States (and, if the Company or such subsidiaries were to qualify for the benefits under the income tax treaty between the United States and Bermuda and other countries in which the Company operates, such businesses were attributable to a “permanent establishment” in the United States), the Company or such subsidiaries could be subject to U.S. tax at regular tax rates on its taxable income that is effectively connected with its U.S. trade or business plus an additional “branch profits” tax (at a rate as high as 30%) on such income remaining after the regular tax, in which case there could be a significant adverse effect on the Company’s results of operations and financial condition.

**(f) Letters of Credit**

At December 31, 2013 and 2012, \$1.9 billion and \$1.8 billion of letters of credit were outstanding, of which 67.6% and 93.3%, respectively, were collateralized by the Company’s investment portfolios, primarily supporting U.S. non-admitted business and the Company’s Lloyd’s syndicates’ capital requirements.

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**15. Commitments and Contingencies**

**(g) Litigation**

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

Legal actions are subject to inherent uncertainties, and future events could change management's assessment of the probability or estimated amount of potential losses from pending or threatened legal actions. Based on available information, it is the opinion of management that the ultimate resolution of pending or threatened legal actions other than claims proceedings, both individually and in the aggregate, will not result in losses having a material adverse effect on the Company's financial position or liquidity at December 31, 2013.

If management believes that, based on available information, it is at least reasonably possible that a material loss (or additional material loss in excess of any accrual) will be incurred in connection with any legal actions, the Company discloses an estimate of the possible loss or range of loss, either individually or in the aggregate, as appropriate, if such an estimate can be made, or discloses that an estimate cannot be made. Based on the Company's assessment at December 31, 2013, no such disclosures are considered necessary.

**(h) Financial and Other Guarantee Exposures**

A summary of the Company's outstanding financial guarantee exposures for the years indicated is as follows:

***Financial Guarantee Exposures***

**Year Ended December 31,**

*(U.S. dollars in thousands except number of contracts and term to maturity)*

	<b>2013</b>	<b>2012</b>
Opening number of financial guarantee contracts.....	4	4
Number of financial guarantee contracts matured, prepaid or commuted during the period .....	(1)	-
Closing number of financial guarantee contracts .....	3	4
Principal outstanding .....	\$ 108,255	\$ 115,464
Interest outstanding .....	\$ -	\$ -
Aggregate exposure outstanding .....	\$ 108,255	\$ 115,464
Total gross claim liability recorded .....	\$ -	\$ 1,399
Total unearned premiums and fees recorded.....	\$ 134	\$ 279
Weighted average contractual term to maturity in years.....	26.0	25.4

The Company's outstanding financial guarantee contracts at December 31, 2013 provide credit support for a variety of collateral types with the exposures comprised of a \$108.3 million notional financial guarantee on three notes backed by zero coupon long dated bonds and bank perpetual securities, including some issued by European financials.. At December 31, 2012, there were no reported events of default on these obligations.

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

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**16. Retirement Plans**

The Company provides pension benefits to eligible employees through various defined contribution and defined benefit retirement plans sponsored by the Company, which vary for each subsidiary. Plan assets are invested principally in equity securities and fixed maturities.

**(a) Defined contribution plans**

The Company has qualified defined contribution plans which are managed externally and whereby employees and the Company contribute a certain percentage of the employee's pensionable salary each month. The Company's contribution generally vests over five years. The Company's expenses for its qualified contributory defined contribution retirement plans were \$47.8 million and \$51.0 at December 31, 2013 and 2012, respectively.

**(b) Defined benefit plans**

The Company maintains defined benefit plans that cover certain employees as follows:

***U.S. Plan***

A qualified non-contributory defined benefit pension plan exists to cover a number of its U.S. employees. The plan was curtailed in 2002 and was closed to new entrants at that time. Under the terms of the curtailment, existing plan participants were no longer entitled to earn additional defined benefits for future services performed after the curtailment date; however, accrued benefits are eligible for annual cost-of-living increases. This plan also includes a non-qualified supplemental defined benefit plan designed to compensate individuals to the extent that their benefits under the Company's qualified plan are curtailed due to IRS Code limitations. Benefits are based on years of service and compensation, as defined in the plan, during the highest consecutive three years of the employee's last ten years of employment.

In addition, certain former employees have received benefit type guarantees, not formally a part of any established plan. The liability recorded with respect to these agreements as at both December 31, 2013 and 2012 was \$3.0 million and \$3.3 million, respectively, representing the entire unfunded projected benefit obligations.

***U.K. Plans***

A contributory defined benefit pension scheme exists in the U.K. (the "Scheme"), but has been closed to new entrants since 1996. Benefits are based on length of service and compensation as defined in the trust deed and rules.

In addition, during 2003 six members, five of whom are still employed by the Company in the U.K., transferred from a defined benefit plan into a defined contribution plan. These employees have a contractual agreement with the Company that provides a "no worse than final salary pension" guarantee in the event that they are employed by the Company until retirement, under which the Company guarantees to top-up their defined contribution pension to the level of pension that they would have been entitled to receive had they remained in the defined benefit scheme. The pension liability recorded with respect to these individuals was \$4.0 million and \$3.5 million at December 31, 2013 and 2012, respectively, representing the entire unfunded projected obligation.

***Other European Plans***

Certain contributory defined benefit pension plans exist in several European countries, most notably Germany, which are closed to new entrants. Benefits are generally based on length of service and compensation defined in the related agreements. As a part of the purchase of XL GAPS, the Company acquired certain defined benefit pension liabilities. The related balances are not included in the tables below as the liabilities are insured under an annuity type contract.

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**16. Retirement Plans**

The funded status by geographical region of all the Company's retirement plans at December 31, 2013 and 2012 is as follows:

*Funded Status*

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
U.S.	\$ (6,181)	\$ (17,210)
U.K.	(7,654)	(8,032)
Other European	(20,983)	(18,528)
Funded status – end of year	<u>\$ (34,818)</u>	<u>\$ (43,770)</u>

The status of all the Company's retirement plans at December 31, 2013 and 2012 is as follows:

**Change in projected benefit obligation:**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Projected benefit obligation - beginning of year	\$ 83,083	\$ 72,267
Service cost (1)	1,491	1,291
Interest cost	3,599	3,557
Actuarial (gain)/loss	(5,091)	7,922
Benefits and expenses paid	(2,307)	(2,069)
Foreign currency (gains)/losses	1,201	1,086
Settlements	-	(971)
Projected benefit obligation - end of year	<u>\$ 81,976</u>	<u>\$ 83,083</u>

(1) Service costs include cost of living adjustments on curtailed plans.

**Change in plan assets:**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Fair value of plan assets - beginning of year	\$ 39,313	\$ 34,956
Actual return on plan assets	6,113	3,101
Employer contributions	2,919	2,133
Benefits and expenses paid	(1,462)	(1,258)
Foreign currency gains/(losses)	275	381
Fair value of plan assets - end of year	<u>\$ 47,158</u>	<u>\$ 39,313</u>
Funded status - end of year	<u>\$ (34,818)</u>	<u>\$ (43,770)</u>
Accrued pension liability	<u>\$ 34,818</u>	<u>\$ 43,770</u>

The components of the net benefit cost for the years ended December 31, 2013 and 2012 are as follows:

**Components of net benefit cost:**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Service cost	\$ 1,491	\$ 1,291
Interest cost	3,589	3,557
Expected return on plan assets	(3,096)	(3,028)
Amortization of net actuarial loss	1,440	915
Transfer from AOCI	-	3,363
Net benefit cost	<u>\$ 3,424</u>	<u>\$ 6,098</u>

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**16. Retirement Plans**

*Assumptions*

Several assumptions and statistical variables are used in the models to calculate the expenses and liability related to the plans. The Company, in consultation with its actuaries, determines assumptions about the discount rate, the expected rate of return on plan assets and the rate of compensation increase. The table below includes disclosure of these rates on a weighted-average basis, for the years ended December 31 as indicated:

	2013			2012		
	U.S. Plans	U.K. Plans	Other European Plans	U.S. Plans	U.K. Plans	Other European Plans
<b>Net Benefit Cost – Weighted-average assumptions</b>						
Discount rate	4.00 %	4.50 %	4.20 %	4.40 %	4.65 %	5.20 %
Expected long-term rate of return on plan assets	8.00 %	5.70 %	N/A	8.00 %	5.70 %	N/A
Rate of compensation increase	N/A	4.90 %	2.50 %	N/A	5.00 %	3.00 %
<b>Benefit Obligation – Weighted-average assumptions</b>						
Discount rate	4.95 %	4.50 %	3.50 %	4.00 %	4.65 %	4.20 %
Rate of compensation increase	N/A	4.90 %	2.50 %	N/A	5.00 %	3.00 %

The expected long-term rate of return assumption is determined by adding expected inflation to the expected long-term real rates of various asset classes taking into account expected volatility and correlation between the various asset classes.

*Plan Assets*

The U.S. Plan assets at December 31, 2013 and 2012 consist of two mutual funds. The first fund employs a core bond portfolio strategy that seeks maximum current income and price appreciation consistent with the preservation of capital and prudent risk taking with the focus on intermediate – term high quality bonds.

The second fund seeks long term growth of capital by investing in a diversified group of domestic and international companies. Using a quantitative approach, portfolio managers identify companies that they believe have favorable prospects for above average growth.

The fair value of the U.S. Plan assets at December 31, 2013 and 2012 was \$36.4 million and \$29.8 million, respectively. As both of the retirement plan's investments are mutual funds, they fall within Level 1 in the fair value hierarchy. The inputs and methodologies used in determining the fair value of these assets are consistent with those used to measure our assets as set out in Note 3, "Fair Value Measurements."

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**16. Retirement Plans**

The U.K. pension plan assets are held in a separate trustee administered fund to meet long term liabilities to past and present employees. The table below shows the composition of the plan's assets and the fair value of each major category of plan assets as of December 31, 2013 and 2012, as well as the potential returns of the different asset classes. The totals of the asset values held in various externally managed portfolios are provided by third party pricing vendors. There is no significant concentration of risk within plan assets. The assets in the scheme and the expected rates of return were as follows:

<i>(U.S. dollars in thousands, except percentages)</i>	<b>Expected Return on Assets for 2013</b>	<b>Weighted Value at December 31, 2013</b>	<b>Expected Return on Assets for 2012</b>	<b>Weighted Value at December 31, 2012</b>
Equities	6.8 %	\$ 7,048	6.8 %	\$ 6,149
Gilts	3.0 %	1,775	3.0 %	1,700
Corporate Bonds	4.5 %	1,758	4.7 %	1,566
Other (cash)	3.4 %	133	3.5 %	68
Total market fair value of assets		<u>\$ 10,714</u>		<u>\$ 9,483</u>

***Expected Cash Flows***

Under the U.S. defined benefit plans, the Company's policy is to make annual contributions to the plan that are deductible for federal income tax purposes and that meet the minimum funding standards required by law. The contribution level is determined by utilizing the projected unit credit cost method and different actuarial assumptions than those used for pension expense purposes. The Company's funding policy provides that contributions to the plan shall be at least equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the Pension Protection Act of 2006. During the fiscal year beginning January 1, 2014, the U.S. defined benefit plans expect to make contributions of \$2.9 million.

The estimated future benefit payments with respect to the U.S. defined benefit pension plans, are as follows:

<i>(U.S. dollars in thousands)</i>	<b>Retirement Plan</b>	<b>Benefits Equalization Plan</b>	<b>Total</b>
2014	\$ 825	\$ 429	\$ 1,254
2015	\$ 870	\$ 425	\$ 1,295
2016	\$ 945	\$ 425	\$ 1,370
2017	\$ 1,008	\$ 421	\$ 1,429
2018	\$ 1,078	\$ 424	\$ 1,502
2019-2023	\$ 8,519	\$ 2,828	\$ 11,347

The U.K. scheme is subject to triennial funding valuations, the most recent of which was conducted as of July 1, 2012 and was reported in 2013. The \$2.5 million deficit (calculated on a realistic basis) is being funded over a 10-year period.

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**17. Accumulated Other Comprehensive Income (Loss)**

The changes in accumulated other comprehensive income (loss), net of tax, by component for the years ended December 31 are as follows:

Dec 31, 2013 YTD (U.S. dollars in thousands)	Unrealized Gains (Losses) on Investments	OTI Losses Recognized in AOCI	Foreign Currency Translation	Underfunded Pension Liability	Total
Balance, January 1 - net of tax	\$ 1,288,407	\$ (70,723)	\$ 84,939	\$ (27,507)	\$ 1,275,116
OCI before reclassifications	(723,732)	—	(64,380)	9,722	(778,390)
Amounts reclassified from AOCI	(93,385)	28,258	206	1,440	(63,481)
Tax (benefit) expense	90,450	(12)	7,868	—	98,306
Net current period OCI - net of tax	(726,667)	28,246	(56,306)	11,162	(743,565)
Balance, Dec 31 - net of tax	<u>\$ 561,740</u>	<u>\$ (42,477)</u>	<u>\$ 28,633</u>	<u>\$ (16,345)</u>	<u>\$ 531,551</u>

  

Dec 31, 2012 YTD (U.S. dollars in thousands)	Unrealized Gains (Losses) on Investments	OTI Losses Recognized in AOCI	Foreign Currency Translation	Underfunded Pension Liability	Total
Balance, January 1 - net of tax	\$ 527,227	\$ (122,426)	\$ 77,712	\$ (17,521)	\$ 464,992
OCI before reclassifications	922,703	—	8,592	(14,259)	917,036
Amounts reclassified from AOCI	(145,023)	51,992	350	4,273	(88,408)
Tax (benefit) expense	(16,500)	(289)	(1,715)	—	(18,504)
Net current period OCI - net of tax	761,180	51,703	7,227	(9,986)	810,124
Balance, Dec 31 - net of tax	<u>\$ 1,288,407</u>	<u>\$ (70,723)</u>	<u>\$ 84,939</u>	<u>\$ (27,507)</u>	<u>\$ 1,275,116</u>



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**17. Accumulated Other Comprehensive Income (Loss)**

The reclassifications out of AOCI along with the associated income statement line items affected by component, and the total related tax (expense) benefit for year ended December 31, 2013 are as follows:

Income	Gross Amount Reclassified From AOCI	
	2013	Affected Line Item in the Statement Where Net Income is Presented
<i>(U.S. Dollars in Thousands)</i>		
Unrealized gains and losses on investments:		
	\$ —	Net investment income
	\$ (100,729)	Net realized gains (losses) on investments sold
	<u>\$ 7,344</u>	OTTI on investments
	\$ (93,385)	Total before tax
	<u>\$ 5,183</u>	Provision (benefit) for income tax
	<u>\$ (88,202)</u>	Net of tax
OTTI losses recognized in OCI:		
	\$ 23,243	Net realized gains (losses) on investments sold
	<u>\$ 5,015</u>	OTTI on investments transferred to (from) OCI
	\$ 28,258	Total before tax
	<u>\$ (12)</u>	Provision (benefit) for income tax
	<u>\$ 28,246</u>	Net of tax
Foreign Currency Translation:		
Liquidation of subsidiary	\$ 206	Exchange gains (losses) - before tax
	<u>\$ —</u>	Provision (benefit) for income tax
	<u>\$ 206</u>	Net of tax
Underfunded Pension Liability		
Pension expense	\$ 1,440	Operating Expenses
	<u>\$ —</u>	Provision (benefit) for income tax
	<u>\$ 1,440</u>	Net of tax
Total reclassifications for the period, gross of tax	\$ (63,481)	
Tax (expense) benefit	<u>\$ 5,171</u>	
Total reclassifications for the period, net of tax	\$ (58,310)	

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**18. Dividends**

The Company paid a dividend of \$698.9 million in 2013, \$609.5 million was cash and \$89.4 million was investments. The Company paid a dividend of \$607.3 million in 2012, \$232.6 million was cash and \$374.7 million was investments.

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**19. Taxation**

The Company and its Bermuda subsidiaries are not subject to any income, withholding or capital gains taxes under current Bermuda law. In the event that there is a change such that these taxes are imposed, the Bermuda subsidiaries would be exempted from any such tax until March 2035 pursuant to the Bermuda Exempted Undertakings Tax Protection Act 1966, and the Exempted Undertakings Tax Protection Amendment Act 2011.

The Company's U.S. subsidiaries are subject to federal, state and local corporate income taxes and other taxes applicable to U.S. corporations. The provision for federal income taxes has been determined under the principles of the consolidated tax provisions of the U.S. Internal Revenues ("IRS") Code and Regulations thereunder.

The Company has operations in subsidiary and branch form in various other jurisdictions around the world, including but not limited to the U.K., Switzerland, Ireland, Germany, France, Canada, Brazil and various other countries in Latin America and Asia that are subject to relevant taxes in those jurisdictions.

Deferred income taxes have not been accrued with respect to certain undistributed earnings of foreign subsidiaries. If the earnings were to be distributed, as dividends or otherwise, such amounts may be subject to withholding taxation in the jurisdiction of the paying entity. During 2010, the Company revised its capital strategy such that it is no longer able to positively assert that all earnings arising in the U.S. will be permanently reinvested in that jurisdiction and, accordingly, a provision for withholding taxes arising in respect of U.S. earnings has been made. No withholding taxes are accrued with respect to the earnings of the Company's subsidiaries arising outside the U.S., as it is the intention that all such earnings will remain reinvested indefinitely.

The Company's current corporate structure is such that distribution of earnings from subsidiaries located outside of the United States would not be subject to significant incremental taxation. It is not practicable to estimate the amount of additional withholding taxes that might be payable on such earnings due to a variety of factors, including the timing, extent and nature of any repatriation.

The following table details the years that are the subject of open examinations, by major tax jurisdiction. While the Company cannot estimate with certainty the outcome of these examinations, the Company does not believe that adjustments from open tax years will result in a significant change to the Company's results from operations.

<b>Jurisdiction</b>	<b>Tax Years</b>
U.S.	2010
Ireland	2006 - 2009
U.K.	2007 - 2010
Germany	2006 - 2009
Switzerland	2009 - 2010

The following table details open tax years that are potentially subject to examinations by local tax authorities, in the following major tax jurisdictions.

<b>Jurisdiction</b>	<b>Tax Years</b>
U.S.	2011 - 2013
Ireland	2009 - 2013
U.K.	2012 - 2013
Germany	2010 - 2013
Switzerland	2009 - 2013
France	2011 - 2013

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**19. Taxation**

The Company's income (loss) before income tax was distributed for the years ended December 31, 2013 and 2012 are as follows:

**Income (loss) before income tax:**

*(U.S. dollars in thousands)*

	<u>2013</u>	<u>2012</u>
U.S.	\$ 188,941	\$ 52,285
Non U.S.	<u>1,072,961</u>	<u>878,120</u>
<b>Total</b>	<u>\$ 1,261,902</u>	<u>\$ 930,405</u>

The income tax provisions for the years ended December 31, 2013 and 2012 are as follows:

*(U.S. dollars in thousands)*

	<u>2013</u>	<u>2012</u>
<b>Current expense:</b>		
U.S. ....	\$ 48,776	\$ 13,105
Non U.S. ....	<u>41,674</u>	<u>46,115</u>
Total current expense .....	<u>\$ 90,450</u>	<u>\$ 59,220</u>
<b>Deferred expense (benefit):</b>		
U.S. ....	\$ 703	\$ (56,646)
Non U.S. ....	<u>(18,639)</u>	<u>33,094</u>
Total deferred expense (benefit) .....	<u>\$ (17,936)</u>	<u>\$ (23,552)</u>
<b>Total tax expense.....</b>	<u><u>\$ 72,514</u></u>	<u><u>\$ 35,668</u></u>

The weighted average expected tax provision has been calculated using the pre-tax accounting income (loss) in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. The applicable statutory tax rates of the most significant jurisdictions contributing to the overall taxation of the Company are:

<b>Jurisdiction</b>	<u><b>Applicable Statutory Taxation Rates</b></u>
Ireland (1)	12.50 %
Ireland (1)	25.00 %
Bermuda	— %
U.S.	35.00 %
U.K.	23.25 %
Switzerland (2)	7.83 %
Switzerland (2)	21.20 %
Germany	15.00 %
France	38.00 %

- (1) The different applicable statutory taxation rates in Ireland relate to entities classified as trading or non-trading companies.
- (2) The different applicable statutory taxation rates in Switzerland relate to entities classified as trading or holding companies.

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**19. Taxation**

Reconciliation of the difference between the provision for income taxes and the expected tax provision at the weighted average tax rate for the years ended December 31, 2013 and 2012 is provided below:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Expected tax provision at weighted average rate .....	\$ 51,345	\$ 67,887
Permanent differences:		
Non-taxable investment income (loss) .....	(9,847)	(16,717)
Non-taxable income (loss) .....	(40,899)	(25,711)
Prior year adjustments .....	1,102	(622)
Prior year adjustments on completion of IRS examinations .....	-	(19,192)
State, local and foreign taxes .....	12,197	18,284
Valuation allowance .....	(3,608)	(13,612)
Allocated investment income .....	5,949	41,726
Stock options .....	263	1,208
Non-deductible expenses .....	26,012	3,793
Realized capital loss carry-forward valuation allowance reduction .....	-	(24,472)
Uncertain tax positions .....	30,000	-
Non-taxable reserve release .....	-	3,096
<b>Total tax expense .....</b>	<b>\$ 72,514</b>	<b>\$ 35,668</b>

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**19. Taxation**

Significant components of the Company's deferred tax assets and liabilities at December 31, 2013 and 2012 were as follows:

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
<b>Deferred tax asset:</b>		
Net unpaid loss reserve discount.....	\$ 105,511	\$ 108,285
Net unearned premiums .....	69,812	70,071
Compensation liabilities.....	62,710	56,245
Net operating losses .....	59,601	54,312
Investment adjustments.....	12,574	12,927
Pension.....	5,670	11,976
Bad debt reserve.....	7,337	14,901
Amortizable goodwill .....	7,976	8,958
Net unrealized depreciation on investments .....	9,985	38,652
Stock options.....	12,171	9,081
Depreciation.....	3,449	1,804
Net realized capital losses .....	140,993	98,971
Deferred intercompany capital losses .....	69,536	97,566
Untaxed Lloyd's result.....	2,533	-
Other .....	9,651	9,498
Deferred tax asset, gross of valuation allowance .....	\$ 579,509	\$ 593,247
Valuation allowance.....	232,266	268,888
Deferred tax asset, net of valuation allowance.....	\$ 347,243	\$ 324,359
<b>Deferred tax liability:</b>		
Net unrealized appreciation on investments .....	\$ 28,843	\$ 106,520
Deferred acquisition costs.....	7,057	16,135
Currency translation adjustments .....	7,195	11,225
Regulatory reserves.....	131,750	146,101
Investment adjustments.....	6,112	-
Untaxed Lloyd's result .....	-	10,155
Other .....	14,732	13,838
Deferred tax liability .....	\$ 195,689	\$ 303,974
<b>Net Deferred Tax Asset .....</b>	<b>\$ 151,554</b>	<b>\$ 20,385</b>

The deferred tax asset and liability balances presented above represent the gross deferred tax asset and liability balances across each tax jurisdiction. The deferred tax asset balances of \$237.9 million and \$162.2 million at December 31, 2013 and 2012, respectively, and deferred tax liability balances of \$86.3 million and \$141.8 million at December 31, 2013 and 2012, respectively, as disclosed on the consolidated balance sheets include netting of certain deferred tax assets and liabilities within a tax jurisdiction to the extent such netting is consistent with the regulations of the tax authorities in those jurisdictions.

At December 31, 2013 and 2012, the valuation allowance of \$232.3 million and \$268.9 million, respectively, related primarily to net operating loss carry forwards and realized capital loss carry forwards as follows:

**Jurisdiction**

*(U.S. dollars in thousands)*

	<b>2013</b>	<b>2012</b>
Switzerland	\$ 12,292	\$ 9,864
Ireland	30,536	30,536
U.S.	175,414	196,555
Other	14,024	31,933
Valuation Allowance Total	\$ 232,266	\$ 268,888

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**19. Taxation**

The reduction in the valuation allowance in 2013 was primarily due to the release of certain valuation allowances held against capital loss carry-forwards in the U.S.

At December 31, 2013, the Company had realized capital loss carry forwards of approximately \$299.5 million in the U.S. (\$104.8 million tax effected). The five year limitation for the utilization of realized capital losses applies to this balance. Losses of \$110.6 million will expire at the end of 2014 with another \$188.9 million of realized capital losses expiring in future years through 2018. A valuation allowance (\$104.8 million) has been established in respect of all of these realized capital losses. At December 31, 2013, the Company also had \$198.7 million of U.S. capital losses arising from the sale of investments to a group company (\$69.5 million tax effected), against which a valuation allowance of \$69.5 million has been established. These losses cannot be utilized to offset any future U.S. realized capital gains, and will not begin to expire, until the underlying assets have been sold to unrelated parties.

At December 31, 2013, net operating loss carry forwards in the U.K. were approximately \$153.4 million (\$34.3 million tax effected) and have no expiration. A valuation allowance of \$1.0 million has been established in respect of \$5.1 million of these U.K. losses given management's expectation that losses in specific U.K. entities will not be utilized in the future.

At December 31, 2013, net operating loss carry forwards in Switzerland were approximately \$84.1 million, of which \$25.6 million will expire at the end of 2014 with the balance expiring in future years through 2020. A valuation allowance of \$9.0 million has been established in respect of \$78.7 million of the Swiss net operating losses, which includes the \$25.6 million of Swiss net operating losses that will expire in 2014.

At December 31, 2013, net operating loss carry forwards in Ireland were approximately \$122.1 million. Although these Irish losses may be carried forward indefinitely, a valuation allowance (\$30.5 million) has been established in respect of all of these Irish losses due to the uncertainty surrounding any future loss utilization.

Management has reviewed historical taxable income and future taxable income projections for its U.K. group and has determined that in its judgment substantially all of the U.K. net operating losses (\$148.2 million) will more likely than not be realized as reductions to future taxable income within a reasonable period. Management will continue to evaluate income generated in future periods by the U.K. group in determining the reasonableness of its position. If management determines that future income generated by the U.K. group is insufficient to cause the realization of the net operating losses within a reasonable period, a valuation allowance would be required for the U.K. portion of the deferred tax asset balance related to net operating losses in the amount of \$33.3 million.

Management believes it is more likely than not that the tax benefit of the remaining net deferred tax assets will be realized.

Shareholders' equity at December 31, 2013 and 2012 reflected tax benefits of \$1.8 million and nil, respectively, related to the excess of tax deductions over book compensation expense deductions for stock options exercised/vested by the Company's U.S. subsidiaries.

The Company adopted the provisions of the final authoritative guidance on accounting for uncertainty in income taxes on January 1, 2007. At December 31, 2013, the Company had unrecognized tax benefits of \$30.0 million. If recognized, the full amount of these unrecognized tax benefits would decrease the annual effective tax rate. The Company does not currently anticipate any significant change in unrealized tax benefits during 2014.

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**19. Taxation**

The following table presents a reconciliation of the Company's unrecognized tax benefits:

<i>(U.S. dollars in thousands)</i>	<u>2013</u>	<u>2012</u>
Unrecognized tax benefits, beginning of the year	\$ —	\$ —
Increases for tax positions taken during the year	9,591	—
Increases for tax positions taken in prior years	20,409	—
Decreases for tax positions taken during the year	—	—
Decreases for tax positions taken in prior years	—	—
Settlement with taxing authorities	—	—
Lapse of statute of limitations	—	—
Unrecognized tax benefits, end of year	<u>\$ 30,000</u>	<u>\$ —</u>

The Company's policy is to recognize any interest and penalties accrued related to unrecognized tax benefits in the tax charge. At December 31, 2013 and 2012 the Company had accrued interest and penalties of \$1.0 million and nil, respectively.



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**20. Statutory Financial Data**

The Company's ability to pay dividends or return capital from shareholders' equity is limited by applicable laws and regulations of the various jurisdictions in which the Company's principal operating subsidiaries operate, certain additional required regulatory approvals and financial covenants contained in the Company's letters of credit and revolving credit facilities. The payment of such dividends 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 the principal operating subsidiaries are licensed to transact business and the other jurisdictions where the Company has regulated subsidiaries. Statutory capital and surplus for the principal operating subsidiaries of the Company for the years ended December 31, 2013 and 2012 are summarized below:

	<b>Bermuda (1)</b>		<b>U.S. (2)</b>		<b>U.K., Europe and Other</b>	
<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Required statutory capital and surplus ..	\$ 6,382,118	\$ 6,497,192	\$ 657,865	\$ 649,166	\$ 1,970,909	\$ 1,679,309
Actual statutory capital and surplus (3)	\$ 10,193,615	\$ 10,328,816	\$ 2,244,505	\$ 2,237,834	\$ 2,686,909	\$ 2,483,484

- (1) Required statutory capital and surplus at December 31, 2013 represents 100% Bermuda Solvency Capital Requirement ("BSCR") level for the top Bermuda operating subsidiary, XL Insurance (Bermuda) Ltd, calculated on a consolidated basis (and therefore includes a BSCR requirement for all regions).  
(2) Required statutory capital and surplus represents 100% RBC level for principal U.S. operating subsidiaries.  
(3) Statutory assets in Bermuda include investments in other U.S. and international subsidiaries reported separately herein.

Statutory net income (loss) for the principal operating subsidiaries of the Company for the years ended December 31, 2013 and 2012 is summarized below:

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Bermuda.....	\$ 1,257,791	\$ 857,832
U.S. ....	124,310	106,510
U.K., Europe and Other .....	(162,085)	144,829

The difference between statutory financial statements and statements prepared in accordance with GAAP varies by jurisdiction, however, the primary difference is that statutory financial statements do not reflect deferred policy acquisition costs, deferred income tax net assets, intangible assets, unrealized appreciation on investments but they do reflect any unauthorized/authorized reinsurance charges.

Certain restrictions on the payment of dividends from retained earnings by the Company's principal operating subsidiaries are further detailed below.

Management has evaluated the principal operating subsidiaries' ability to maintain adequate levels of statutory capital, liquidity and rating agency capital and believes they will be able to do so. In performing this analysis, management has considered the most recent statutory capital position of each of the principal operating subsidiaries as well as the ability of the holding companies to allocate capital and liquidity around the group as and when needed.

**Bermuda Operations**

In early July 2008, the Insurance Amendment Act of 2008 was passed, which introduced a number of changes to the Bermuda Insurance Act 1978, such as allowing the Bermuda Monetary Authority (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. Insurers and reinsurers 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, 2009. The Company's capital requirements for its Bermuda principal operating subsidiaries, XL Re Ltd and XL Insurance (Bermuda) Ltd, under the BSCR are highlighted in the table above. In addition to the BSCR based requirements, the BMA also prescribes minimum liquidity standards which must be met.

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**20. Statutory Financial Data**

Under the Insurance Act 1978, amendments thereto and related regulations of Bermuda, Class 4 (re)insurers are prohibited from declaring or paying dividends of more than 25% of each of their prior year's statutory capital and surplus unless they file with the BMA an affidavit stating that the dividend has not caused the Class 4 (re)insurer to fail to meet its relevant margins. At December 31, 2013 and 2012, the maximum dividend that our Bermuda Class 4 (re)insurers could pay, without a signed affidavit, having met minimum levels of statutory capital and surplus and liquidity requirements, was approximately \$1.4 billion and \$1.4 billion, respectively. No Class 4 (re)insurer may reduce its total statutory capital by 15% or more unless it has received the prior approval of the BMA, and it must also submit an affidavit stating that the proposed reduction will not cause it to fail to meet its minimum solvency margin or minimum liquidity ratio.

**U.S. Operations**

Unless permitted by the New York Superintendent of Insurance, the Company's lead property and casualty subsidiary in the United States ("XLRA") may not pay dividends to shareholders in an aggregate amount in any twelve month period that exceeds the lesser of 10 percent of XLRA's statutory policyholders' surplus or 100 percent of its "adjusted net investment income," as defined. The New York State insurance law also provides that any distribution that is a dividend may only be paid out of statutory earned surplus. At December 31, 2013 and 2012, XLRA had statutory earned surplus of \$180.5 million and \$152.9 million, respectively. At December 31, 2013, XLRA's statutory policyholders' surplus was \$2.2 billion, and accordingly, the maximum amount of dividends XLRA can declare and pay in 2014, without prior regulatory approval, is \$180.5 million. At December 31, 2013 and 2012, none of the seven property and casualty subsidiaries of XLRA had a statutory earned deficit.

**International Operations**

The Company's international principal operating subsidiaries prepare statutory financial statements based on local laws and regulations. Some jurisdictions impose enhanced regulatory requirements on insurance companies while other jurisdictions impose fewer requirements. In some countries, such subsidiaries must obtain licenses issued by governmental authorities to conduct local insurance business. These licenses may be subject to minimum reserves and minimum capital and solvency tests. Jurisdictions may impose fines, censure, and/or impose criminal sanctions for violation of regulatory requirements. The majority of the actual statutory capital outside of the U.S. and Bermuda is held in Ireland (\$0.9 billion at December 31, 2013) and the U.K. (\$1.2 billion at December 31, 2013). The Company's Irish operating subsidiary, XL Re Europe SE, is required to seek prior approval from the Irish regulator to reduce its share capital or to pay dividends.

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**22. Related Party Transactions**

At December 31, 2013 and 2012, the Company owned minority stakes in five and four, respectively, independent investment management companies ("Investment Manager Affiliates") that are actively managing client capital and seeking growth opportunities. The Company seeks to develop relationships with specialty investment management organizations, generally acquiring an equity interest in the business. The Company also invests in certain of the funds and limited partnerships and other legal entities managed by these affiliates and through these funds and partnerships pays management and performance fees to the Company's Investment Manager Affiliates. See Note 5, "Investment in Affiliates," included herein, for further information.

In the normal course of business, the Company enters into reinsurance contracts with certain of its other strategic affiliates, or their subsidiaries. During the years ended December 31, 2013 and 2012, these contracts resulted in reported net premiums written, net reported claims and reported acquisition costs as summarized below. Management believes that these transactions are conducted at market rates consistent with negotiated arms-length contracts.

<i>(U.S. dollars in thousands)</i>	<b>2013</b>	<b>2012</b>
Reported net premiums written.....	\$ 73,085	\$ 61,146
Net losses incurred.....	\$ 29,042	\$ 37,664
Reported acquisition costs .....	\$ 25,275	\$ 24,014