XL CAPITAL LTD
Form 10-Q/A
November 09, 2006

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

FORM 10-Q/A
(Amendment No. 1)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-10804

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

CAYMAN ISLANDS	98-0191089
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

XL House, One Bermudiana Road, Hamilton, Bermuda HM 11
(Address of principal executive offices and zip code)
(441) 292-8515
(Registrant's telephone number, including area code)

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

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

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

As of August 2, 2006, there were 180,409,046 outstanding Class A Ordinary Shares, $0.01 par value per share, of the registrant.

XL CAPITAL LTD

INDEX TO FORM 10-Q

See accompanying Notes to Unaudited Consolidated Financial Statements

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (this Amendment) amends the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 filed on August 9, 2006 (the Original Filing). XL Capital Ltd has filed this Amendment to correct certain errors in the Unaudited Consolidated Statements of Cash Flows as described in Note 11, Retatement of Consolidated Statements of Cash Flows, as well as to make corresponding textual changes in Item 2, Managements Discussion and Analysis of Financial Condition and Results of Operations and to add related information in Item 4, Controls and Procedures. Other information contained herein has not been updated. Therefore, you should read this Amendment together with other documents and reports that we have filed with the Securities and Exchange Commission subsequent to the filing of the Original Filing. Information in such documents and reports updates and supersedes certain information contained in this Amendment. More current information with respect to XL Capital Ltd. is contained within its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, and other filings with the Securities and Exchange Commission.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share amounts)

	(Unaudited) June 30, 2006	December 31, 2005
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2006, $33,247,738; 2005, $31,984,076)	$ 32,792,886	$ 32,309,565
Equity securities, at fair value (cost: 2006, $707,118; 2005, $696,858)	838,364	868,801
Short-term investments, at fair value (amortized cost: 2006, $2,776,907; 2005, $2,552,589)	2,772,074	2,546,073
Total investments available for sale	36,403,324	35,724,439
Investments in affiliates	2,021,256	2,046,721
Other investments	442,797	399,417
Total investments	38,867,377	38,170,577
Cash and cash equivalents	2,566,768	3,693,475
Accrued investment income	398,552	391,660
Deferred acquisition costs.	972,655	866,200
Prepaid reinsurance premiums	1,260,633	1,067,556
Premiums receivable	4,432,477	3,799,041
Reinsurance balances receivable	1,026,890	1,043,013
Unpaid losses and loss expenses recoverable	6,148,443	6,441,522
Goodwill and other intangible assets	1,817,503	1,814,544
Deferred tax asset, net	344,527	318,399
Other assets	691,528	848,914
Total assets	$ 58,527,353	$ 58,454,901
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 23,733,500	$ 23,767,672
Deposit liabilities	7,559,896	8,240,987
Future policy benefit reserves	6,069,691	5,606,461
Unearned premiums	6,372,442	5,388,996
Notes payable and debt	3,367,887	3,412,698
Reinsurance balances payable	1,038,022	1,414,752
Net payable for investments purchased	450,548	639,034
Other liabilities	1,331,236	1,438,234
Minority interest	56,847	74,256

Total liabilities	$ 49,980,069	$ 49,983,090

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share amounts)

	(Unaudited) June 30, 2006	December 31, 2005
Commitments and Contingencies		
Shareholders Equity:		
Series A preference ordinary shares, 9,200,000 authorized, par value $0.01 Issued and outstanding: 2006 and 2005, 9,200,000	$ 92	$ 92
Series B preference ordinary shares, 11,500,000 authorized, par value $0.01 Issued and outstanding: 2006 and 2005, 11,500,000	115	115
Series C preference ordinary shares, 20,000,000 authorized, par value $0.01 Issued and outstanding 2006 and 2005, nil		
Class A ordinary shares, 999,990,000 authorized, par value $0.01 Issued and outstanding: 2006, 180,394,236; 2005, 179,528,593	1,804	1,795
Additional paid in capital	6,426,468	6,472,839
Accumulated other comprehensive (loss) income	(403,842)	268,243
Deferred compensation		(95,464)
Retained earnings	2,522,647	1,824,191
Total shareholders equity	$ 8,547,284	$ 8,471,811
Total liabilities and shareholders equity	$ 58,527,353	$ 58,454,901

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF INCOME
(U.S. dollars in thousands, except per share amounts)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Revenues:				
Net premiums earned	$ 1,984,590	$ 3,712,768	$ 3,803,139	$ 5,612,203
Net investment income	473,622	367,401	937,364	675,606
Net realized (losses) gains on investments	(23,604)	90,055	(839)	150,726
Net realized and unrealized gains (losses) on derivative instruments	29,238	(47,941)	78,089	(2,763)
Net income (loss) from investment affiliates	28,849	(10,774)	135,242	59,738
Fee income and other	6,630	(3,048)	19,592	14,112
Total revenues	$ 2,499,325	$ 4,108,461	$ 4,972,587	$ 6,509,622
Expenses:				
Net losses and loss expenses incurred	$ 1,119,561	$ 1,261,707	$ 2,216,685	$ 2,404,768
Claims and policy benefits	232,453	2,020,664	375,333	2,146,291
Acquisition costs	295,512	310,988	562,599	605,382
Operating expenses	279,464	248,950	541,025	496,106
Exchange losses (gains)	22,693	(10,693)	53,442	229
Interest expense	134,632	97,766	262,501	186,052
Amortization of intangible assets	420	3,043	1,515	5,836
Total expenses	$ 2,084,735	$ 3,932,425	$ 4,013,100	$ 5,844,664
Income before minority interest, income tax and equity in net (income) of insurance and financial affiliates	$ 414,590	$ 176,036	$ 959,487	$ 664,958
Minority interest in net income of subsidiary	—	2,079	2,258	4,354
Income tax	66,437	41,776	133,073	94,650
Net (income) from operating affiliates	(39,016)	(13,794)	(31,596)	(33,046)
Net income	387,169	145,975	855,752	599,000
Preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)

Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares and ordinary share equivalents outstanding basic	178,728	138,948	179,631	138,488
Weighted average ordinary shares and ordinary share equivalents outstanding diluted	179,198	140,404	180,069	139,841
Earnings per ordinary share and ordinary share equivalent basic	$ 2.11	$ 0.98	$ 4.65	$ 4.18
Earnings per ordinary share and ordinary share equivalent diluted	$ 2.10	$ 0.97	$ 4.64	$ 4.14

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(U.S. dollars in thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Change in net unrealized (depreciation) appreciation of investments, net of tax	(357,247)	388,243	(756,485)	44,103
Amortization of derivative loss on cash flow hedge	157	157	312	313
Foreign currency translation adjustments, net	85,762	61,252	96,998	79,322
Net unrealized (loss) gain on future policy benefit reserves	(10,401)	2,508	(12,910)	5,590
Comprehensive income	$ 105,440	$ 598,135	$ 183,667	$ 728,328

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2006	**2005**
Series A and B Preference Ordinary Shares:		
Balance beginning of year	$ 207	$ 207
Issue of shares		
Balance end of period	$ 207	$ 207
Class A Ordinary Shares:		
Balance beginning of year	$ 1,795	$ 1,389
Issue of shares	8	8
Exercise of stock options	2	8
Repurchase of shares	(1)	(1)
Balance end of period	$ 1,804	$ 1,404
Additional Paid in Capital:		
Balance beginning of year	$ 6,472,839	$ 3,950,175
Issue of shares	51,122	60,306
Repurchase of ordinary shares	(2,199)	(1,630)
Stock option expense	11,856	9,685
Exercise of stock options	8,422	34,515
Equity reclassification impact of adopting FAS 123(r)	(95,464)	
Net change in deferred compensation	(20,108)	
Balance end of period	$ 6,426,468	$ 4,053,051
Accumulated Other Comprehensive Income:		
Balance beginning of year	$ 268,243	$ 460,273
Net change in unrealized gains (losses) on investment portfolio, net of tax	(774,908)	41,125
Net change in unrealized gains (losses) on investment portfolio of affiliates	18,423	2,978
Amortization of derivative loss on cash flow hedge	312	313
Net unrealized gains (losses) on future policy benefit reserves	(12,910)	5,590
Currency translation adjustments	96,998	79,322
Balance end of period	$ (403,842)	$ 589,601
Deferred Compensation:		
Balance beginning of year	$ (95,464)	$ (69,988)
Issue of restricted shares		(57,604)
Amortization		20,477

Equity reclassification impact of adopting FAS 123(r)	95,464	
Balance end of period	$	$ (107,115)
Retained Earnings:		
Balance beginning of year	$ 1,824,191	$ 3,396,639
Net income	855,752	599,000
Dividends on Series A and B preference ordinary shares	(20,160)	(20,160)
Dividends on Class A ordinary shares	(134,885)	(138,186)
Repurchase of ordinary shares	(2,251)	(2,765)
Balance end of period	$ 2,522,647	$ 3,834,528
Total Shareholders Equity	$ 8,547,284	$ 8,371,676

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2006 (as restated)	**2005 (as restated)**
Cash flows provided by operating activities:		
Net income	$ 855,752	$ 599,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized losses (gains) on investments	839	(150,726)
Net realized and unrealized (gains) losses on derivative instruments	(78,089)	2,763
Amortization of (discounts) premiums on fixed maturities	(1,206)	30,380
Equity in net income from investment, insurance and financial affiliates	(166,838)	(92,784)
Amortization of deferred compensation	30,004	20,477
Accretion of convertible debt	481	485
Accretion of deposit liabilities	160,203	105,219
Unpaid losses and loss expenses	(440,853)	518,186
Future policy benefit reserves	59,806	1,806,417
Unearned premiums	888,142	985,440
Premiums receivable.	(543,051)	(761,279)
Unpaid losses and loss expenses recoverable	415,205	311,612
Prepaid reinsurance premiums	(177,704)	(130,415)
Reinsurance balances receivable	40,543	66,666
Deferred acquisition costs	(89,499)	(121,351)
Reinsurance balances payable	(380,239)	(43,852)
Deferred tax asset	1,990	75,411
Other assets	197,670	(160,757)
Other	(11,017)	145,873
Total adjustments	$ (93,613)	$ 2,607,765
Net cash provided by operating activities	$ 762,139	$ 3,206,765
Cash flows used in investing activities:		
Proceeds from sale of fixed maturities and short-term investments	$ 11,074,558	$ 10,900,166
Proceeds from redemption of fixed maturities and short-term investments	650,275	647,275
Proceeds from sale of equity securities	789,977	603,350
Purchases of fixed maturities and short-term investments	(12,778,203)	(15,688,895)
Purchases of equity securities	(723,646)	(556,562)
Investments in affiliates, net of dividends received	186,969	2,252

Acquisition of subsidiaries, net of cash acquired	(12,600)	
Other investments	(39,155)	24,240
Other assets	4,097	
Net cash used in investing activities	$ (847,728)	$ (4,068,174)
Cash flows provided by financing activities:		
Proceeds from exercise of stock options and issuance of common shares	7,941	40,446
Repurchase of shares	(4,451)	(4,396)
Dividends paid	(155,045)	(158,348)
Repayment of loans	(45,291)	
Deposit liabilities	(786,898)	1,260,109
Net cash flow on securities lending	(81,112)	(71,834)
Net cash (used in) provided by financing activities	(1,064,856)	1,065,977
Effects of exchange rate changes on foreign currency cash	23,738	(32,954)
(Decrease) increase in cash and cash equivalents	(1,126,707)	171,614
Cash and cash equivalents beginning of period	3,693,475	2,203,726
Cash and cash equivalents end of period	$ 2,566,768	$ 2,375,340

See accompanying Notes to Unaudited Consolidated Financial Statements

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

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

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. There was no effect on net income from this change in presentation.

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

2. Significant Accounting Policies

(a) Stock-Based compensation

Effective January 1, 2003, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (FAS) No. 123, *Accounting for Stock-Based Compensation* (FAS 123), as amended by FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (FAS 148), under the prospective method for options granted subsequent to January 1, 2003. Prior to 2003, the Company accounted for options under the disclosure-only provisions of FAS 123 and no stock-based employee compensation cost was included in net income as all options granted had an exercise price equal to the market value of the Companys ordinary shares on the date of the grant. At June 30, 2006, the Company had several stock based Performance Incentive Programs, which are described more fully in Note 19 to the consolidated financial statements filed on Form 10-K/A for the year ended December 31, 2005. Stock-based compensation issued under these plans generally have a life of not longer than ten years and vest as set forth at the time of grant. Options currently vest annually over three or four years from the date of grant.

In 2004, the FASB issued SFAS No.123 (revised 2004) (FAS 123(r)), Share-Based Payment, which is a revision of SFAS 123. SFAS 123(r) superseded FAS 123, APB 25 and amended SFAS 95, Statement of Cash Flows. Generally, the approach to accounting for share-based payments in FAS 123(r) is similar to the approach described in FAS 123, which the Company adopted on a prospective basis in 2003. However, FAS 123(r) requires all share-based payments to employees, including grants of employee stock options (for all grant years), to be recognized in the financial statements over the vesting period based on their grant date fair values.

The Company adopted FAS 123(r) effective January 1, 2006 using the modified-prospective method to account for share-based payments made to employees. The modified-prospective method is similar to the modified-prospective method described in SFAS 148. Under this method, compensation cost is recognized beginning with the effective date (a) based on the requirements of FAS 123(r) for all share-based payments granted after the effective date and (b) based on the requirements of FAS 123(r) for all awards granted to employees prior to the effective date of FAS 123(r) that remain unvested on the effective date.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

2. Significant Accounting Policies (continued)

	Three and Six Months Ended June 30, 2006	Three and Six Months Ended June 30, 2005
Dividend yield	2.1%	2.6%
Risk free interest rate	4.7%	4.0%
Expected volatility	25.0%	25.0%
Expected lives	5.5 years	5.5 years

In the first six months of 2006 and 2005, the Company granted 182,800 and 1,877,500 options, respectively, to purchase its ordinary shares to directors and employees related to incentive compensation plans, with a weighted average grant-date fair value of $17.33 and $17.04, respectively. During the three-month periods ended June 30, 2006 and 2005, the Company recognized $5.7 million and $5.5 million, respectively, of compensation expense, net of tax, related to its stock option plans. During the six-month periods ended June 30, 2006 and 2005, the Company recognized $10.4 million and $9.7 million, respectively, of compensation expense, net of tax, related to its stock option plan. Total intrinsic value of stock options exercised during the six-month periods ended June 30, 2006 and 2005 was $2.7 million and $14.8 million, respectively.

The following is a summary of stock options as of June 30, 2006, and related activity for the six months ended June 30, 2006:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (000s)
Outstanding beginning of period	12,745,290	75.35	6.0 years	
Granted	182,800	67.58		
Exercised	(163,657)	49.92		
Cancelled	(380,892)	78.32		
Outstanding end of period	12,383,541	75.48	5.4 years	$19,480
Options exercisable	9,888,823		4.8 years	$19,480
Options available for grant*	12,850,862			

* Available for grant includes shares that may be granted as either stock options or restricted stock.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between XLs closing stock price on the last trading day of the second quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money-options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. Total unrecognized stock based compensation expense related to non-vested stock options was approximately $39.1 million as of the end of June 30, 2006, related to approximately 12.4 million options, which is expected to be recognized over a weighted-average period of 1.6 years.

In the first six-months of 2006, the Company incurred no additional stock based compensation due to the adoption of FAS 123(r) related to the vesting in 2006 of options granted prior to January 1, 2003, as all options granted prior to that date had been fully vested by June 30, 2006.

For all periods presented prior to 2006, and for all options granted prior to January 1, 2003, the Company accounted for stock option grants under the recognition and measurement principles of APB 25 and related interpretations and accordingly, recognized no compensation expense for these stock options granted to employees. The following table

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Significant Accounting Policies (continued)

illustrates the effect on earnings per share for the three-month and six-month periods ended June 30, 2005, if the Company had applied the fair value recognition provisions of SFAS 123 to all of its stock-based employee compensation:

(U.S. dollars in thousands, except per share amounts)	(Unaudited) Three Months Ended June 30, 2005	(Unaudited) Six Months Ended June 30, 2005
Net income available to ordinary shareholders as reported	$ 135,895	$ 578,840
Add: Stock based employee compensation expense included in reported net income, net of related tax	5,508	9,685
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(6,189)	(14,318)
Pro forma net income available to ordinary shareholders	$ 135,214	574,207
Earnings per share:		
Basic as reported	$0.98	$4.18
Basic pro forma	$0.97	$4.15
Diluted as reported	$0.97	$4.14
Diluted pro forma	$0.96	$4.11

Restricted stock awards issued under the 1991 Performance Incentive Program vest as set forth in the applicable award agreements. These shares contained certain restrictions prior to vesting, relating to, among other things, forfeiture in the event of termination of employment and transferability.

In first six months of 2006 and 2005, the Company granted 758,362 and 864,686 shares, respectively, of its restricted common stock to its directors and employees related to incentive compensation plans, with a weighted average grant date fair value per share of $66.59 and $75.47, respectively. During the three-month periods ended June 30, 2006 and 2005, $11.0 million and $11.3 million, respectively, was charged to compensation expense related to restricted stock awards. During the six-month periods ended June 30, 2006 and 2005, $30.0 million and $20.5 million, respectively, was charged to compensation expense related to restricted stock awards. Total unrecognized stock based compensation expense related to non-vested restricted stock awards was approximately $115.6 million as of the end of June 30, 2006, related to approximately 1.9 million restricted stock awards, which is expected to be recognized over 2.8 years. Non-vested restricted stock awards as of June 30, 2006 and for the six months then ended were as follows:

	Number of shares (thousands)	Weighted-Average Grant Date Fair Value
Unvested at December 31, 2005	1,529	$62.43
Granted	758	$66.59
Vested	(333)	$74.91

Forfeited	(89)	$73.97
Unvested at June 30, 2006	1,865	$72.06

FAS 123(r) 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 has adopted this 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 options granted. In the first six months of 2006, the Company incurred $6.4 million of additional stock based compensation expense due to the adoption of FAS 123(r) related to this treatment of retirement eligible employees as compared to the previous attribution methodology.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Recent Accounting Pronouncements

In February 2006, the FASB issued FAS 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140*. This standard permits fair value re-measurement of an entire hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; narrows the scope exemption applicable to interest-only strips and principal-only strips from FAS 133, clarifies that only the simplest separations of interest payments and principal payments qualify as not being subject to the requirements of FAS 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends FAS140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is intended to require more consistent accounting that eliminates exemptions and provides a means to simplify the accounting for hybrid financial instruments. This statement is effective for all financial instruments acquired or issued after January 1, 2007 and is not expected to have a material impact on the Companys financial condition or results of operations. As at June 30, 2006 the Company has not elected to apply the fair value option for any hybrid financial instruments.

In April 2006, the FASB issued FSP FIN 46(R)-6, *Determining the Variability to be Considered in Applying FIN 46(R)*, which states that the variability to be considered when applying FIN 46(R) should be based on an analysis of the design of an entity, which entails analyzing the nature of the risks in the entity, determining the purpose for which the entity was created and determining the variability the entity is designed to create and pass along to its interest holders. Typically, assets and operations of the entity create the variability (and thus are not variable interests), while liabilities and equity interests absorb that variability (and thus, are variable interests). The role of a contract or arrangement in the design of the entity, regardless of its legal form or accounting classification, shall dictate whether that interest should be treated as creating or absorbing variability for the entity. The guidance in this FSP must be applied as of July 1, 2006, and is not expected to have a material impact on the Companys financial condition or results of operations but will form an important part of the Companys evaluation of any relevant structures going forward.

In June 2006, the FASB issued proposed FSP FAS 123(R)-e, *Amendment of FASB Staff Position FAS 123(R)-1*, which addresses whether the modification of an instrument in connection with an equity restructuring or a business combination should be considered a modification for purposes of applying FSP FAS 123(R)-1, *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)*. The FASB staff has taken the position that for instruments that were originally issued as employee compensation and then exchanged or changed, where the only change is a change to the terms of an award to reflect an equity restructuring or a business combination that occurs when the holders are no longer employees, then no change in the recognition and measurement (due to a change in classification) of these instruments will result if, there is (i) no increase in value to the holders of the instrument or (ii) the exchange or change in the terms of the award is not made in contemplation of an equity restructuring or a business combination and (iii) all holders of the same class of equity instruments (for example, stock options) are treated in a similar manner. These provisions must be applied in the first reporting period beginning after the date the final FSP is posted to the FASBs website. This guidance is not expected to have a significant impact on the Companys financial condition or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprises financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The evaluation of a tax position in accordance with this guidance is a two-step process. The first step is recognition where the Company determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Recent Accounting Pronouncements (continued)

processes, based on the technical merits of the position. The second step is measurement where a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. FIN 48 requires qualitative and quantitative disclosures, including discussion of reasonably possible changes that might occur in the recognized tax benefits over the next 12 months; a description of open tax years by major jurisdictions; and a roll-forward of all unrecognized tax benefits, presented as a reconciliation of the beginning and ending balances of the unrecognized tax benefits on a worldwide aggregated basis. The provisions of FIN 48 must be applied beginning January 1, 2007. The Company is currently evaluating the impact of this guidance on the Company's financial condition and results of operations.

4. Segment Information

The Company is organized into four operating segments – Insurance, General Reinsurance, Life and Annuity Reinsurance and Financial Products and Services – in addition to a Corporate segment that includes the general investment and financing operations of the Company. Following changes in executive management responsibilities in 2006, the Company now considers the Life and Annuity Reinsurance business as a separate operating segment. General operations include property and casualty lines of business.

The Company evaluates the performance of each segment based on underwriting results for general operations, net income from life and annuity operations and contribution from financial operations. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate assets by segment for its general operations. Investment assets related to the Company's life and annuity and financial operations are held in separately identified portfolios. Net investment income from these assets is included in net income from life and annuity operations and contribution from financial operations, respectively.

Following changes in certain executive management responsibilities in January 2005, the Company changed the reporting segments under which certain business units are reported in order to reflect these changes in responsibilities.

- Results of business structured by XL Financial Solutions Ltd ("XLFS") are now included entirely within the Financial Products and Services segment whereas previously this unit was reported in all three segments, depending on the nature of individual contracts.
- Certain blocks of U.S.-based term life mortality reinsurance business previously included in the Financial Products and Services segment are now included in the Reinsurance segment as management of these contracts was transferred to the life reinsurance business units in order to centralize the Company's management of traditional mortality-based reinsurance business.
- Political risk insurance business units now report to executive management of the Financial Products and Services segment and, as such, earnings from this business are no longer reported in the Insurance segment but included with financial operations.
- All operations of business units within the Financial Products and Services segment, including municipal reinvestment contracts and funding agreements, are now reported under financial operations in order to consolidate businesses with similar operating characteristics and risks.
- Net investment income and net income from affiliates generated by assets and interest expense incurred on liabilities of the business units within the Financial Products and Services segment is reported under

financial operations. This income and expense is included in financial operations as it relates to interest on portfolios of separately identified and managed assets and deposit liabilities.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 1,029,135	$ 671,871	$ —	$ 1,701,006
Fee income and other	7,099	(2,109)	—	4,990
Net losses and loss expenses	681,728	372,613	—	1,054,341
Acquisition costs	113,555	159,485	—	273,040
Operating expenses (1)	157,604	45,077	—	202,681
Exchange (gains) losses	46,324	(21,083)	—	25,241
Underwriting profit	$ 37,023	$ 113,670	$ —	$ 150,693
Life and Annuity Operations:				
Life premiums earned	$ —	$ 179,894	$ —	$ 179,894
Fee income and other	—	128	—	128
Claims and policy benefits	—	232,453	—	232,453
Acquisition costs	—	12,279	—	12,279
Operating expenses (1)	—	5,446	—	5,446
Exchange losses (gains)	—	(2,864)	—	(2,864)
Net investment income	—	85,371	—	85,371
Interest expense	—	—	—	—
Net income from life and annuity operations	$ —	$ 18,079	$ —	$ 18,079
Financial Operations:				
Net premiums earned			$ 103,690	$ 103,690
Fee income and other			1,512	1,512
Net losses and loss expenses			65,220	65,220
Acquisition costs			10,193	10,193
Operating expenses (1)			20,399	20,399
Exchange losses			316	316
Underwriting profit			$ 9,074	$ 9,074
Net investment income — financial guarantee			$ 18,323	$ 18,323
Net investment income — structured products			108,487	108,487

Interest expense structured products	80,521	80,521
Operating expenses structured products (1)	11,625	11,625
Net income from financial and investment affiliates	12,255	12,255
Minority interest		
Net results from derivatives (2)	3,887	3,887
Contribution from financial operations	$ 59,880	$ 59,880

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2006 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 261,441
Net realized and unrealized gains on investments and derivative instruments (3)				1,747
Net income from investment and operating affiliates				55,610
Interest expense (4)				54,111
Amortization of intangible assets				420
Corporate operating expenses				39,313
Income tax				66,437
Net Income				$ 387,169
General Operations:				
Loss and loss expense ratio (5)	66.2%	55.5%		62.0%
Underwriting expense ratio (5)	26.4%	30.4%		28.0%
Combined ratio (5)	92.6%	85.9%		90.0%

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

(2) Includes net realized and unrealized gains on credit derivatives of $2.7 million, and weather and energy derivatives of $1.9 million and losses on structured financial derivatives of $0.7 million.

(3) This includes net realized losses on investments of $23.6 million and net realized and unrealized gains on investment derivatives of $25.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 1,054,360	$ 673,201	$ —	$ 1,727,561
Fee (loss) income and other	(2,916)	(463)	—	(3,379)
Net losses and loss expenses	676,374	568,154	—	1,244,528
Acquisition costs	119,032	149,049	—	268,081
Operating expenses (1)	140,261	38,153	—	178,414
Exchange (gains) losses	(34,104)	21,895	—	(12,209)
Underwriting profit (loss)	$ 149,881	$ (104,513)	$ —	$ 45,368
Life and Annuity Operations:				
Life premiums earned	$ —	$ 1,933,215	$ —	$ 1,933,215
Fee income and other	—	114	—	114
Claims and policy benefits	—	2,020,664	—	2,020,664
Acquisition costs	—	35,058	—	35,058
Operating expenses (1)	—	5,068	—	5,068
Exchange losses	—	403	—	403
Net investment income	—	71,963	—	71,963
Interest expense	—	—	—	—
Net loss from life and annuity operations	$ —	$ (55,901)	$ —	$ (55,901)
Financial Operations:				
Net premiums earned			$ 51,992	$ 51,992
Fee income and other			217	217
Net losses and loss expenses			17,179	17,179
Acquisition costs			7,849	7,849
Operating expenses (1)			17,338	17,338
Exchange losses			1,113	1,113
Underwriting profit			$ 8,730	$ 8,730
Net investment income — financial guarantee			$ 14,986	$ 14,986
Net investment income — structured products			70,725	70,725

Interest expense structured products	54,134	54,134
Operating expenses structured products (1)	13,439	13,439
Net loss from financial and investment affiliates	(7,437)	(7,437)
Minority interest	2,300	2,300
Net results from derivatives (2)	17,487	17,487
Contribution from financial operations	$ 34,618	$ 34,618

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Three months ended June 30, 2005 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 209,727
Net realized and unrealized gains on investments and derivative instruments (3)				24,627
Net income from investment and operating affiliates				10,457
Interest expense (4)				43,632
Amortization of intangible assets				3,043
Corporate operating expenses				34,691
Minority interest				(221)
Income tax				41,776
Net Income				$ 145,975
General Operations:				
Loss and loss expense ratio (5)	64.2%	84.4%		72.0%
Underwriting expense ratio (5)	24.5%	27.8%		25.9%
Combined ratio (5)	88.7%	112.2%		97.9%

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

(2) Includes net realized and unrealized losses on credit derivatives of $4.0 million, and gains on weather and energy derivatives of $4.1 million and structured financial derivatives of $17.4 million.

(3) This includes net realized gains on investments of $90.1 million and net realized and unrealized losses on investment derivatives of $65.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

<u>Six months ended June 30, 2006:</u>
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 2,060,432	$ 1,306,998	$ —	$ 3,367,430
Fee income and other	14,494	817	—	15,311
Net losses and loss expenses	1,359,235	759,701	—	2,118,936
Acquisition costs	241,249	282,524	—	523,773
Operating expenses (1)	295,682	84,653	—	380,335
Exchange losses (gains)	77,035	(17,669)	—	59,366
Underwriting profit	$ 101,725	$ 198,606	$ —	$ 300,331
Life and Annuity Operations:				
Life premiums earned	$ —	$ 270,559	$ —	$ 270,559
Fee income and other	—	194	—	194
Claims and policy benefits	—	375,333	—	375,333
Acquisition costs	—	21,554	—	21,554
Operating expenses (1)	—	11,924	—	11,924
Exchange losses (gains)	—	(6,238)	—	(6,238)
Net investment income	—	163,994	—	163,994
Net income from life and annuity operations	$ —	$ 32,174	$ —	$ 32,174
Financial Operations:				
Net premiums earned			$ 165,150	$ 165,150
Fee income and other			4,087	4,087
Net losses and loss expenses			97,749	97,749
Acquisition costs			17,272	17,272
Operating expenses (1)			38,682	38,682
Exchange losses			314	314
Underwriting profit			$ 15,220	$ 15,220
Net investment income — financial guarantee			$ 35,400	$ 35,400
Net investment income — structured products			214,162	214,162
Interest expense — structured products			158,040	158,040

Operating expenses structured products (1)	21,629	21,629
Net income from financial and investment affiliates	18,704	18,704
Minority interest	2,258	2,258
Net results from structured derivatives (2)	22,815	22,815
Contribution from financial operations	$ 124,374	$ 124,374

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2006 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 523,808
Net realized and unrealized gains on investments and derivative instruments (3)				54,435
Net income from investment and operating affiliates				148,134
Interest expense (4)				104,461
Amortization of intangible assets				1,515
Corporate operating expenses				88,455
Income tax				133,073
Net Income				$ 855,752
General Operations:				
Loss and loss expense ratio (5)	66.0%	58.1%		62.9%
Underwriting expense ratio (5)	26.0%	28.1%		26.9%
Combined ratio (5)	92.0%	86.2%		89.8%

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

(2) Includes net realized and unrealized gains on credit derivatives of $1.4 million, weather and energy derivatives of $22.9 million and losses on structured financial derivatives of $1.5 million.

(3) This includes net realized losses on investments of $0.8 million, net realized and unrealized gains on investment derivatives of $55.2 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

<u>Six months ended June 30, 2005:</u>
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 2,136,878	$ 1,356,952	$ —	$ 3,493,830
Fee income (loss) and other	1,011	(446)	—	565
Net losses and loss expenses	1,401,889	978,504	—	2,380,393
Acquisition costs	257,775	291,239	—	549,014
Operating expenses (1)	266,129	79,559	—	345,688
Exchange (gains) losses	(19,789)	18,281	—	(1,508)
Underwriting profit (loss)	$ 231,885	$ (11,077)	$ —	$ 220,808
Life and Annuity Operations:				
Life premiums earned	$ —	$ 2,014,686	$ —	$ 2,014,686
Fee income and other	—	179	—	179
Claims and policy benefits	—	2,146,291	—	2,146,291
Acquisition costs	—	41,409	—	41,409
Operating expenses (1)	—	9,251	—	9,251
Exchange losses	—	673	—	673
Net investment income	—	131,866	—	131,866
Net loss from life and annuity operations	$ —	$ (50,893)	$ —	$ (50,893)
Financial Operations:				
Net premiums earned			$ 103,687	$ 103,687
Fee income and other			13,368	13,368
Net losses and loss expenses			24,375	24,375
Acquisition costs			14,959	14,959
Operating expenses (1)			34,894	34,894
Exchange losses			1,064	1,064
Underwriting profit			$ 41,763	$ 41,763
Net investment income — financial guarantee			$ 29,504	$ 29,504
Net investment income — structured products			132,579	132,579
			96,544	96,544

Interest expense structured products		
Operating expenses structured products (1)	23,197	23,197
Net loss from financial and investment affiliates	(809)	(809)
Minority interest	4,575	4,575
Net results from derivatives (2)	33,565	33,565
Contribution from financial operations	$ 112,286	$ 112,286

See footnotes on following page.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2005 (continued):
(U.S. dollars in thousands, except ratios)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income general operations				$ 381,657
Net realized and unrealized gains on investments and derivative instruments (3)				114,398
Net income from investment and operating affiliates				93,593
Interest expense (4)				89,508
Amortization of intangible assets				5,836
Corporate operating expenses				83,076
Minority interest				(221)
Income tax				94,650
Net Income				$ 599,000
General Operations:				
Loss and loss expense ratio (5)	65.6%	72.1%		68.1%
Underwriting expense ratio (5)	24.5%	27.3%		25.6%
Combined ratio (5)	90.1%	99.4%		93.7%

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

(2) Includes net realized and unrealized gains on credit derivatives of $6.2 million, weather and energy derivatives of $10.2 million and structured financial derivatives of $17.2 million.

(3) This includes net realized gains on investments of $150.7 million and net realized and unrealized losses on investment derivatives of $36.3 million, but does not include unrealized appreciation or depreciation on investments, which are included in accumulated other comprehensive income (loss).

(4) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

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

Three months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 435,284	$ 96,088	$ —
Casualty	242,748	199,212	—
Property catastrophe	28,748	68,758	—
Other property	160,707	167,699	—
Marine, energy, aviation and satellite	130,395	38,601	—
Other (1)	31,253	101,513	—
Total general operations	$ 1,029,135	$ 671,871	$ —
Life and annuity operations	—	179,894	—
Financial operations	—	—	103,690
Total	$ 1,029,135	$ 851,765	$ 103,690

(1) Other, includes bonding, warranty, accident and health and other lines of business.

Three months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 348,743	$ 90,755	$ —
Casualty	275,811	226,405	—
Property catastrophe	23,300	70,273	—
Other property	149,308	149,588	—
Marine, energy, aviation and satellite	184,747	43,997	—
Other (1)	72,451	92,183	—
Total general operations	$ 1,054,360	$ 673,201	$ —

Life and annuity operations		1,933,215	
Financial operations			51,992
Total	$ 1,054,360	$ 2,606,416	$ 51,992

(1) Other, includes bonding, warranty, accident and health and other lines of business.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information (continued)

Six months ended June 30, 2006:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 802,578	$ 178,456	$ —
Casualty	484,002	377,546	—
Property catastrophe	48,211	122,802	—
Other property	336,055	352,155	—
Marine, energy, aviation and satellite	303,037	74,031	—
Other (1)	86,549	202,008	—
Total general operations	$ 2,060,432	$ 1,306,998	$ —
Life and Annuity Operations	—	270,559	—
Financial Operations	—	—	165,150
Total	$ 2,060,432	$ 1,577,557	$ 165,150

(1) Other, includes bonding, warranty, accident and health and other lines of business.

Six months ended June 30, 2005:
(U.S. dollars in thousands)
(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
General Operations:			
Professional liability	$ 714,011	$ 181,348	$ —
Casualty	561,466	452,388	—
Property catastrophe	43,180	136,236	—
Other property	310,916	332,698	—
Marine, energy, aviation and satellite	391,612	85,272	—
Other (1)	115,693	169,010	—
Total general operations	$ 2,136,878	$ 1,356,952	$ —
Life and annuity operations	—	2,014,686	—
Financial operations	—	—	103,687

Total	$ 2,136,878	$ 3,371,638	$ 103,687

(1) Other, includes bonding, warranty, accident and health and other lines of business.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Derivative Instruments

The Company enters into investment, structured financial and weather and energy derivative instruments for both risk management and trading purposes. The Company also enters into credit derivatives in connection with its Financial Products and Services business. The Company is exposed to potential loss from various market risks and manages its market risks based on guidelines established by senior management. All these derivative instruments are carried at fair value.

The following table summarizes the net realized and unrealized gains on derivative instruments included in net income for the three and six months ended June 30, 2006 and 2005:

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
(U.S. dollars in thousands)	**2006**	**2005**	**2006**	**2005**
Credit derivatives	$ 2,644	$ (4,011)	$ 1,382	$ 6,238
Weather and energy risk management derivatives	1,938	4,112	22,926	10,166
Other non-investment derivatives	(695)	17,386	(1,493)	17,161
Net results from derivatives financial operations	$ 3,887	$ 17,487	$ 22,815	$ 33,565
Investment derivatives	25,351	(65,428)	55,274	(36,328)
Net realized and unrealized gains (losses) on derivatives	$ 29,238	$ (47,941)	$ 78,089	$ (2,763)

The Company records premiums received from sales of investment grade credit derivatives in gross written premiums and establishes loss reserves for this derivative business. These loss reserves represent the Company's best estimate of the probable losses expected under these contracts. Net realized and unrealized gains and losses on credit derivative instruments are computed as the difference between fair value and the net of unpaid losses and loss expenses and unpaid losses and loss expenses recoverable. Changes in unrealized gains and losses on credit derivative instruments are reflected in the consolidated statements of income. Cumulative unrealized gains and losses are reflected as assets and liabilities, respectively, in the Company's consolidated balance sheet. Net realized and unrealized gains and losses resulting from changes in the fair value of derivatives occur because of changes in interest rates, credit spreads, recovery rates, the credit ratings of the referenced entities and other market factors.

The following table summarizes insurance activities related to credit default swap derivative instruments excluding gains and losses on credit default swaps within the investment portfolio.

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
(U.S. dollars in thousands)	**2006**	**2005**	**2006**	**2005**
Statement of Income:				

Net earned premiums	$ 5,951	$ 6,269	$ 11,749	$ 14,446
Net losses and loss expenses	$ 503	$ (10,154)	$ 615	$ (8,028)
Net realized and unrealized gains (losses) on credit derivatives	$ 2,644	$ (4,011)	$ 1,382	$ 6,238

(U.S. dollars in thousands)	(Unaudited) As at June 30, 2006	As at December 31, 2005
Balance Sheet:		
Unpaid losses and loss expenses recoverable	$ 865	$ 471
Other assets	$ 13,994	$ 15,768
Unpaid losses and loss expenses	$ 16,397	$ 27,562
Other liabilities	$ 17,482	$ 20,142

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. Notes Payable and Debt and Financing Arrangements

The Company closed a new $500 million syndicated credit facility on May 9, 2006. The new facility has a tenor of 364-days and is available for letters of credit only.

7. Exposures under Guaranties

The Company provides financial guaranty insurance and reinsurance to support public and private borrowing arrangements. Financial guaranty insurance guarantees the timely payment of principal and interest on insured obligations to third party holders of such obligations in the event of default by an issuer. The Company’s potential liability in the event of non-payment by the issuer of an insured or reinsured obligation represents the aggregate outstanding principal insured or reinsured under its policies and contracts and related interest payable at the date of default. In addition, the Company provides credit protection on specific referenced credits or on pools of specific referenced credits through the issuance of credit default swaps. Under the terms of credit default swaps, the seller of credit protection makes a specified payment to the buyer of credit protection upon the occurrence of one or more specified credit events with respect to a reference obligation or entity. The Company’s potential liability under credit default swaps represents the notional amount of such swaps.

At June 30, 2006, the Company’s net outstanding par exposure under its in-force financial guaranty insurance and reinsurance policies and contracts aggregated to $104.5 billion and net reserves for losses and loss adjustment expenses relating to such exposures was $167.3 million at such date. In addition, at June 30, 2006, the Company’s notional exposure under credit default swaps aggregated to $17.7 billion and the net liability for these credit default swaps reflected in the Company’s balance sheet at June 30, 2006 was $19.0 million.

8. XL Capital Finance (Europe) plc

XL Capital Finance (Europe) plc (“XLFE”) is a wholly owned finance subsidiary of the XL Capital Ltd. In January 2002, XLFE issued $600.0 million par value 6.5% Guaranteed Senior Notes due January 2012. These Notes are fully and unconditionally guaranteed by the XL Capital Ltd. XL Capital Ltd’s ability to obtain funds from its subsidiaries is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates including Bermuda, the U.S. and the U.K., among others. Required statutory capital and surplus for the principal operating subsidiaries of the Company was $4.1 billion as of December 31, 2005.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2006	2005	2006	2005
Basic earnings per ordinary share:				
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares outstanding	178,728	138,948	179,631	138,488
Basic earnings per ordinary share	$ 2.11	$ 0.98	$ 4.65	$ 4.18
Diluted earnings per ordinary share:				
Net income	$ 387,169	$ 145,975	$ 855,752	$ 599,000
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	$ 377,089	$ 135,895	$ 835,592	$ 578,840
Weighted average ordinary shares outstanding basic	178,728	138,948	179,631	138,488
Average stock options outstanding (1)	470	1,456	438	1,353
Weighted average ordinary shares outstanding diluted	179,198	140,404	180,069	139,841
Diluted earnings per ordinary share	$ 2.10	$ 0.97	$ 4.64	$ 4.14
Dividends per ordinary share	$ 0.38	$ 0.50	$ 0.76	$ 1.00

(1) Net of shares repurchased under the treasury stock method.

10. Subsequent event sale of financial guaranty business

On August 1, 2006, the Company completed the sale of approximately 35 percent of its financial guaranty insurance and reinsurance businesses (the transferred business) through the initial public offering (IPO) of 22.4 million common shares of Security Capital Assurance Company Ltd. (SCA) at $20.50 per share. SCA was incorporated in Bermuda during March 2006 for the purpose of becoming a holding company for the transferred business. Subsequent to the IPO, the Company owns 42.2 million common shares, or approximately 65 percent of SCA’s outstanding common shares. If the underwriters of the IPO fully exercise their option to purchase an additional 2.2 million common shares at the IPO price of $20.50 per share less the underwriting discount, the Company will ultimately retain 39.4 million common shares, or approximately 61% of SCA. Such option is exercisable through September 1, 2006.

In addition, as part of the overall structuring of the IPO transaction, certain formation transactions occurred in order to move all units included in the IPO under SCA. In addition, in connection with the IPO, the Company has entered into reinsurance agreements with SCA to retain certain insurance risks along with the related liabilities. At their inception, these contracts had no effect on the Company’s income. In addition, the Company has entered into arrangements to provide adverse development protection to SCA related to certain limited risks where the Company would pay up to the limits of the underlying coverages. The Company has also entered into a number of agreements with SCA that will govern certain aspects of the relationship after the IPO, including service agreements under which the Company will provide certain services to SCA for a limited period of time.

Upon completion of the IPO, the Company received proceeds, of approximately $85.5 million. The Company expects the transaction to result in an estimated after tax loss in the range of $40.0 million to $60.0 million, representing the difference between the carrying value of 100% of SCA immediately prior to the IPO and the sum of the proceeds and remaining carrying value of XL Capital’s ownership interest in SCA subsequent to the IPO. The ultimate loss within this range is dependent upon the equity of SCA as of the date of the IPO and will be reflected in the Company’s operating results for the third quarter of 2006.

11. Restatement of Unaudited Consolidated Statements of Cash Flows

The Unaudited Consolidated Statements of Cash Flows for the six month periods ended June 30, 2006 and 2005 have been restated. The Company had incorrectly included the impact of foreign exchange rate changes on Cash flows provided by operating activities, Cash flows used in investing activities, Cash flows provided by financing activities and Effects of exchange rate changes on foreign currency cash in the Company s Consolidated Statements of Cash Flows and, therefore, a restatement was required to eliminate the impact of those rate changes on balances held in certain foreign currency denominated subsidiaries from those financial statements

The following Condensed Statements of Consolidated Cash Flows for the six month periods ended June 30, 2006 and 2005 set forth the effects of these restatements:

	Six Months Ended June 30, 2006		
	As Previously Reported	**Adjustments**	**As Restated**
Net cash provided by operating activities	$ 1,281,480	$ (519,341)	$ 762,139
Net cash used in investing activities	(1,344,510)	496,782	(847,728)
Net cash used in financing activities	(1,062,700)	(2,156)	(1,064,856)
Effects of exchange rate changes on foreign currency cash	(977)	24,715	23,738
Net change in cash and cash equivalents	$ (1,126,707)	$ --	$ (1,126,707)
Cash and cash equivalents at the beginning of year	$ 3,693,475	$ --	$ 3,693,475
Cash and cash equivalents at the end of year	$ 2,566,768	$ --	$ 2,566,768

	Six Months Ended June 30, 2005		
	As Previously Reported	**Adjustments**	**As Restated**
Net cash provided by operating activities	$ 2,631,050	$ 575,715	$ 3,206,765
Net cash used in investing activities	(3,523,519)	(544,655)	(4,068,174)
Net cash provided by financing activities	1,065,717	260	1,065,977
Effects of exchange rate changes on foreign currency cash	(1,634)	(31,320)	(32,954)
Net change in cash and cash equivalents	$ 171,614	$ --	$ 171,614

Cash and cash equivalents at the beginning of year	$	2,203,726	$	--	$	2,203,726
Cash and Cash Equivalents at the end of the year	$	2,375,340	$	--	$	2,375,340

ITEM 2. MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

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

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

Restatements

As further described in Note 11 to the Unaudited Consolidated Financial Statements, the Company has determined that certain adjustments are required to restate the Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003 and the three and six month periods ended March 31 and June 30, 2006, respectively. On November 5, 2006, management of XL Capital Ltd (the Company) determined that the Company had incorrectly included the impact of foreign exchange rate changes on Cash flows provided by operating activities, Cash flows used in investing activities, Cash flows provided by financing activities and Effects of exchange rate changes on foreign currency cash in the Companys Consolidated Statements of Cash Flows and, therefore, a restatement is required to eliminate the impact of those rate changes on balances held in certain foreign currency denominated subsidiaries from those financial statements.

As a result of the restatement, Net cash provided by operating activities for the six months ended June 30, 2006 has been reduced to $762.1 million (from $1.3 billion previously reported), and for the first six months of 2005 has been increased to $3.2 billion (from $2.6 billion previously reported). No change will occur with respect to Cash and cash equivalents at the end of any period, and no restatement of the income statements or balance sheets is required.

The re-presentation of the Companys Consolidated Statements of Cash Flows will not impact the Companys previously reported Consolidated Statements of Income or Consolidated Balance Sheets and, in particular, Cash and cash equivalents reported at the end of any period in the Companys Consolidated Statements of Cash Flows remains unchanged.

This discussion and analysis should be read in conjunction with the Managements Discussion and Analysis of Financial Condition and Results of Operations, and the audited Consolidated Financial Statements and notes thereto, presented under Item 7 and Item 8, respectively, of the Companys Form 10-K/A for the year ended December 31, 2005.

Executive Overview

See Executive Overview in Item 7 of the Companys Form 10-K/A for the year ended December 31, 2005.

Results of Operations

The following table presents an analysis of the Companys net income available to ordinary shareholders and other financial measures (described below) for the three months ended June 30, 2006 and 2005:

(U.S. dollars and shares in thousands, except per share amounts) (Unaudited)

	Three Months Ended June 30,	
	2006	2005
Net income available to ordinary shareholders	$ 377,089	$ 135,895
Earnings per ordinary share — basic	$ 2.11	$ 0.98
Earnings per ordinary share — diluted	$ 2.10	$ 0.97
Weighted average number of ordinary shares and ordinary share equivalents — basic	178,728	138,948
Weighted average number of ordinary shares and ordinary share equivalents — diluted	179,198	140,404

The following table presents an analysis of the Company's net income available to ordinary shareholders and other financial measures (described below) for the six months ended June 30, 2006 and 2005.

(U.S. dollars and shares in thousands, except per share amounts)	**(Unaudited) Six Months Ended June 30,**	
	2006	**2005**
Net income available to ordinary shareholders	$ 835,592	$ 578,840
Earnings per ordinary share basic	$ 4.65	$ 4.18
Earnings per ordinary share diluted	$ 4.64	$ 4.14
Weighted average number of ordinary shares and ordinary share equivalents basic	179,631	138,488
Weighted average number of ordinary shares and ordinary share equivalents diluted	180,069	139,841

The Company's net income and other financial measures as shown below for the three and six months ended June 30, 2006 have been affected, among other things, by the following significant items:

1) Continuing competitive underwriting environment.

Overall market conditions remain attractive across most property and casualty lines.

In the insurance segment competitive forces have varied in different markets. Primary Casualty is competitive in a
Excess Casualty market is generally flat on retained business, with certain lines of business, including healthcare,
increases.

In Property insurance lines, the Company has significantly reduced overall catastrophe exposure while maintainin
gross basis. However, increased reinsurance costs during the July 1, 2006 renewals will impact the Company's ne
the remainder of the year.

D&O rates are down approximately 6% across the year to date renewed book, with the market less competitive in
Other Professional Liability pricing has been relatively stable with certain specialty lines showing improved pricin
overall industry capacity reduction.

Pricing on the Company's program business increased by over 50% on renewed business, heavily impacted by cat
Company expects that the impact of these increases will diminish going forward, as risk management efforts will c
catastrophe exposures.

In the reinsurance segment, July 1, 2006 property lines renewals have had premium rate increases in excess of 10
the 2005 natural catastrophes and other U.S. property lines had rate increases of between 20% and 100% depend
are hurricane exposed. A few large European property programs renew mid year and these programs have had 15

U.S. Casualty reinsurance rates remain attractive, with treaty rates flat to slightly down but facultative rates still r

The Company's results have also been impacted during the first six months of 2006 by the overall risk management initiatives put in place to reduce catastrophe exposure to property and marine and offshore energy lines of business. The Company has reduced its aggregate catastrophe exposure in the six months ended June 30, 2006 through selective underwriting in areas such as the Gulf of Mexico and the exclusion of certain risks where possible. The Company has also generally made higher reinsurance cessions on most short tail lines, in particular to Cyrus Reinsurance Limited, which covers property catastrophe reinsurance and retrocessional business. The impact of these initiatives was most notable in net premiums written in the first half of 2006 and these initiatives are expected to negatively impact net premiums earned over the balance of the year.

2) Growing asset base and positive contribution from investment affiliates.

Net investment income was $937.4 million for the six months ended June 30, 2006 compared to $675.6 million for the same period in 2005. This increase resulted from a larger investment base combined with higher investment yields primarily due to increases in U.S. interest rates. The increase in the size of the investment portfolio resulted from equity raised in the fourth quarter of 2005, growth in structured and spread balances and positive cash flows from operations.

Net income from investment affiliates was $135.2 million for the six months ended June 30, 2006, compared to $59.7 million for the same period in 2005. These results reflect strong returns from the Company's alternative fund investments during the first half of 2006, as well as strong results from certain private equity investments.

Financial Measures

The following are some of the financial measures management considers important in evaluating the Company's operating performance:

(U.S. dollars in thousands, except ratios and per share amounts)

	(Unaudited) Three Months Ended June 30,	
	2006	**2005**
Underwriting profit general operations	$ 150,693	$ 45,368
Combined ratio general operations	90.0%	97.9%
Investment income general operations	$ 261,441	$ 209,727

	(Unaudited) Six Months Ended June 30,	
	2006	**2005**
Underwriting profit general operations	$ 300,331	$ 220,808
Combined ratio general operations	89.8%	93.7%
Investment income general operations	$ 523,808	$ 381,657
Annualized return on average ordinary shareholders' equity	20.9%	15.4%

	(Unaudited) June 30, 2006	**December 31, 2005**
Book value per ordinary share	$ 44.51	$ 44.31

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Underwriting profit general operations

One way the Company evaluates the performance of its property and casualty insurance and reinsurance general operations is the underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned and fee income, less net losses incurred and expenses related to the underwriting activities. Underwriting profits in the three and six month periods ended June 30, 2006 are primarily reflective of the combined ratio discussed below.

Combined ratio general operations

The combined ratio for general operations is used by the Company, and many other property and casualty insurance and reinsurance companies, as another measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net premiums earned for the Companys general insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss. Decreases in the Companys combined ratio for the three and six months ended June 30, 2006, compared to the same periods in the previous year, were primarily a result of a lower loss and loss expense ratio partially offset by an increasing underwriting expense ratio. The decrease in the loss and loss expense ratio was primarily due to the absence of the U.S. casualty reinsurance charge which took place in the second quarter of 2005, partially offset by continued pricing pressures across most lines of business. The increased underwriting expanse ratio has been driven largely by the reduced earned premium levels.

Net investment income general operations

Net investment income from the Companys general operations is an important measure that affects the Companys overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Companys investment portfolio provides liquidity for claims settlements of these reserves as they become due and thus a significant part of the portfolio is in fixed income securities. Net investment income is affected by the size of the portfolio and also overall market interest rates. The average size of the investment portfolio outstanding during the three and six months ended June 30, 2006 increased as compared to the same periods in 2005 due to the Companys issuance of ordinary shares and equity units in the fourth quarter of 2005 and its positive operating cash flow. Total investments as at June 30, 2006 were $38.9 billion as compared to $33.9 billion as at June 30, 2005. Interest rates in the United States have risen since the second quarter of 2005, which also contributed to the increase in investment income.

Book value per ordinary share

Management also views the Companys book value per ordinary share as an additional measure of the Companys performance. Book value per ordinary share is calculated by dividing ordinary shareholders equity by the number of outstanding ordinary shares at any period end. Book value per ordinary share is affected primarily by the Companys net income (loss) and also by any changes in the net unrealized gains and losses on its investment portfolio. Book value per ordinary share has increased by $0.20 in the first half of 2006 as compared to an increase of $3.97 in the first half of 2005. The factors noted above have created $835.6 million in net income for the six months ended June 30, 2006, which increases book value. However, the net unrealized gains associated with the Companys investment portfolio as at December 31, 2005 have decreased by $756.5 million net of tax for the first six months of 2006 resulting in a net unrealized loss position. This decline was driven primarily by increasing interest rates in the U.S., U.K. and the Euro zone. Book value declined as at June 30, 2006, compared with that as at June 30, 2005, due to the net positive impact of the above items being more than offset by the increased average number of shares outstanding following the Companys issuance of common shares in the fourth quarter of 2005.

Other Key Focuses of Management

See the discussion of the Other Key Focuses of Management in Item 7 of the Companys Form 10-K/A for the year ended December 31, 2005. That discussion is updated with the disclosures set forth below.

Initial Public Offering of Financial Guarantee Business

On August 1, 2006, the Company completed the sale of approximately 35 percent of its financial guaranty insurance and reinsurance businesses (the “transferred business”) through the initial public offering (“IPO”) of 22.4 million common shares of Security Capital Assurance Company Ltd (“SCA”) at $20.50 per share. SCA was incorporated in Bermuda during March 2006 for the purpose of becoming a holding company for the transferred business. Subsequent to the IPO, the Company owns 42.2 million common shares, or approximately 65 percent of SCA’s outstanding common shares. If the underwriters of the IPO fully exercise their option to purchase an additional 2.2 million common shares at the IPO price of $20.50 per share less the underwriting discount, the Company will ultimately retain 39.4 million common shares, or approximately 61% of SCA. Such option is exercisable through September 1, 2006.

In addition, as part of the overall structuring of the IPO transaction, certain formation transactions occurred in order to move all units included in the IPO under SCA. In addition, in connection with the IPO, the Company has entered into reinsurance agreements with SCA to retain certain insurance risks along with the related liabilities. At their inception, these contracts had no effect on the Company’s income. In addition, the Company has entered into arrangements to provide adverse development protection to SCA related to certain limited risks where the Company would pay up to the limits of the underlying coverages. The Company has also entered into a number of agreements with SCA that will govern certain aspects of the relationship after the IPO, including service agreements under which the Company will provide certain services to SCA for a limited period of time.

Upon completion of the IPO the Company received proceeds, of approximately $85.5 million. The Company expects the transaction to result in an estimated after tax loss in the range of $40.0 million to $60.0 million, representing the difference between the carrying value of 100% of SCA immediately prior to the IPO and the sum of the proceeds and remaining carrying value of XL Capital’s ownership interest in SCA subsequent to the IPO. The ultimate loss within this range is dependent upon the equity of SCA as of the date of the IPO and will be reflected in the Company’s operating results for the third quarter of 2006.

Ratings and Capital Management

The Company’s ability to underwrite business is dependent upon the quality of its claim paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Company’s financial strength rating was downgraded, its ability to write business may be adversely affected.

In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claim paying and financial strength ratings. The Company is actively working to address these needs with several key business initiatives.

To address these needs, management entered into certain catastrophe risk reduction measures and strategic initiatives intended to reduce volatility while, at the same time, improving the quality of the Company’s risk adjusted returns. These measures include the Company’s cessions to Cyrus Reinsurance Limited and reducing the Company’s catastrophe exposures in the Company’s Global Risk Property Insurance book, the International Catastrophe Insurance Managers, LLC portfolio (“iCAT”), the Reinsurance Property Risk book and our Offshore Marine & Energy books in both Insurance and Reinsurance.

Management Structure

A new Office of the Chief Executive Officer (“OCEO”) has been formed effective July 1, 2006. It is comprised of five senior executive functions including the Company’s Chief Financial Officer, Chief Investment Officer (designate), Chief Executive - Global Business Services and two newly-created roles, Chief Operating Officer and Chief of Staff. This new structure is designed to provide a focused, enterprise-wide framework to allow the Company’s business leaders to leverage strategic opportunities and execute on business priorities.

Henry C.V. Keeling, formerly Global Head of Business Services and Chief Executive of Reinsurance Life Operations, has been appointed Chief Operating Officer. Mr. Keeling assumes broad strategic responsibility for the Companys underwriting risk assumption businesses, including insurance, general reinsurance, life reinsurance and financial products. Clive Tobin, Chief Executive Officer Insurance, and Jamie Veghte, Chief Executive Officer Reinsurance General Operations, continue in those roles, as members of the Companys Executive Management Board and as the key leaders of the Companys property and casualty segments, reporting to Mr. Keeling.

Fiona E. Luck, formerly Global Head of Corporate Services, has been appointed Chief of Staff. In her new position, Ms. Luck is responsible for management of the Companys Legal and Corporate Actuarial functions in addition to her existing role managing a wide range of other holding company functions including Corporate Strategy, Human Resources, Corporate Communications, Marketing and Corporate Social Responsibility.

Jerry de St. Paer and Sarah E. Street continue in their roles as Chief Financial Officer and Chief Investment Officer (designate), respectively, and will become part of the OCEO.

Mr. Michael C. Lobdell, a former Managing Director of New York-based JPMorganChase, will join the Company in September to serve as Chief Executive - Global Business Services. Mr. Lobdell will be responsible for overall execution and service delivery across the entire company and will oversee infrastructure and project management, including IT systems and technology, procurement, real estate, facilities, outsourcing and offshoring.

Winterthur International

Under the terms of the Sale and Purchase Agreement (the SPA), as amended, between XL Insurance (Bermuda) Ltd (XLI) and Winterthur Swiss Insurance Company (WSIC), WSIC provided the Company with post-closing protection determined as of June 30, 2004 with respect to, among other things, adverse development of reserves and premium on certain Winterthur International Insurance business. This protection was based upon net loss experience and development over a three-year, post-closing seasoning period based on actual loss development experience, collectible reinsurance and certain other factors set forth in the SPA. The SPA included a process for determining the amount due from WSIC by an independent actuarial process whereby the Independent Actuary developed a value of the seasoned net reserves. The actual final seasoned net reserves amount was the submission that was closest to the number developed by the Independent Actuary.

As the Company and WSIC were unable to come to an agreement, the Company submitted to WSIC notice to trigger the independent actuarial process as contemplated by the SPA. On February 3, 2005, both the Company and WSIC made submissions for the independent actuarial process. There were two separate numbers submitted - that for the Seasoned Net Reserves Amount (SNRA) and that for the Net Premium Receivable Amount (NPRA). Subsequent to this date neither party had the opportunity to submit revised figures to the Independent Actuary.

On November 23, 2005 the Company received the draft report from the Independent Actuary in connection with the Companys post-closing protection. The final report was received on December 6, 2005. The Independent Actuarys report concluded that WSIC submitted SNRA and NPRA were closest to the Independent Actuarys determinations of SNRA and NPRA. These determinations resulted in the Company receiving a net lump sum payment in the amount of approximately $575.0 million (including interest receivable) from WSIC. As the Company had recorded $1.4 billion in unpaid losses and loss expenses recoverable related to this protection, a loss of approximately $834.2 million was recorded in the fourth quarter of 2005.

Under the terms of the SPA, WSIC provided the Company with protection with respect to third party reinsurance receivables and recoverables related to the acquisition of certain Winterthur International insurance operations (the Winterthur Business), which were approximately $1.6 billion, in the aggregate, as of June 30, 2006. Such protections were in the form of Sellers Retrocession Agreements and a Liquidity Facility.

On June 7, 2006, subsidiaries of the Company entered into an agreement (the Agreement) with WSIC. The purpose of this Agreement is to release all actual or potential disputes, claims or issues arising out of or related in

any way to: (i) the Liquidity Facility and the Sellers Retrocession Agreements, as well as (ii) subject to certain exceptions, the SPA. The Agreement further provides for a four-year term, collateralized escrow arrangement (the Fund) of up to $185 million (plus interest) to protect subsidiaries of the Company from future nonperforming third party reinsurance related to the Winterthur Business. The Fund has been structured to align the parties interests by providing for any sums remaining in the Fund at the end of its term to be shared in agreed percentages.

The Agreement replaces the protections provided to the Company from WSIC for reinsurance receivables and recoverables under the Liquidity Facility and Sellers Retrocession Agreements noted above, and described in the Companys Annual Report on Form 10-K/A for the year ended December 31, 2005 and the Companys Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.

Foreign Exchange Exposure

In the normal course of business, the Company is exposed to foreign exchange fluctuations on various items on its financial statements, in particular investments and unpaid losses and loss expenses. This exposure also exists on certain inter-company balances which are eliminated for consolidation purposes. The Company attempts to manage this economic exposure through matching foreign currency denominated liabilities with foreign currency denominated assets. While unrealized foreign exchange gains and losses on underwriting balances are reported in earnings, the offsetting unrealized gains and losses on invested assets are recorded as separate component of shareholders equity. This results in an accounting mismatch, which will result in foreign exchange gains or loss depending on the movement in certain currencies. In order improve administrative efficiencies as well as to address this accounting imbalance, the Company formed several branches with Euro and U.K. Sterling functional currencies during the first half of 2006. Management will continue to focus on attempting to limit this type of exposure in the future.

Critical Accounting Policies and Estimates

See the discussion of the Companys Critical Accounting Policies and Estimates in Item 7 of the Companys Form 10-K/A for the year ended December 31, 2005. That discussion is updated for disclosures set forth below.

Unpaid Losses and Loss Expenses and Unpaid Loss and Loss Expenses Recoverable

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

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

b) Losses incurred but not reported (IBNR).

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

With respect to the Companys insurance operations, the Company is notified of insured losses and records a case reserve for the estimated amount of the settlement, if any. The estimate reflects the judgment of claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of legal counsel. Reserves are also established to provide for the estimated

expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. With respect to the Company's reinsurance general operations, case reserves for reported claims are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the estimated ultimate cost of a loss. The uncertainty in the reserving process for reinsurers is due, in part, to the time lags inherent in reporting from the original claimant to the primary insurer to the reinsurer. As a predominantly broker market reinsurer for both excess-of-loss and proportional contracts, the Company is subject to a potential additional time lag in the receipt of information as the primary insurer reports to the broker who in turn reports to the Company. As of December 31, 2005, the Company did not have any significant back-log related to our processing of assumed reinsurance information.

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

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

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

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

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

When estimating IBNR reserves, each of the Company's insurance and reinsurance business units segregate business into exposure classes (over 200 classes are reviewed in total). Within each class, the business is further segregated by either the year in which the contract incepted ("underwriting year"), the year in which the claim occurred ("accident year"), or the year in which the claim is reported ("report year"). The majority of the insurance segment is reviewed on an accident year basis. The majority of the reinsurance segment is reviewed on an underwriting year basis.

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

Over time, as a greater number of claims are reported, actuarial estimates of IBNR are based on the BF and loss development techniques. The BF method utilizes actual loss data and the expected patterns of loss emergence, combined with an initial expectation of ultimate losses to determine an estimate of ultimate losses. This method may be appropriate when there is limited actual loss data and a relatively less stable pattern of loss emergence. The chain ladder method utilizes actual loss and expected patterns of loss emergence to determine an estimate of ultimate losses that is independent of the initial expectation of ultimate losses. This method may be appropriate when there is a relatively stable pattern of loss emergence and a relatively larger number of reported claims. Multiple estimates of ultimate losses using a variety of actuarial methods are calculated for many, but not all, of the Company's (200+) classes of business for each year of loss experience. The Company's actuaries look at each class and determine the most appropriate point estimate based on the characteristics of the particular class and other relevant factors, such as historical ultimate loss ratios, the presence of individual large losses, and known occurrences that have not yet resulted in reported losses. Once the Company's actuaries make their determination of the most appropriate point estimate for each class, this information is aggregated and presented to management for review and approval.

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

Such estimates are not precise because, among other things, they are based on predictions of future developments and estimates of future trends in claim severity, claim frequency, and other issues. In the process of estimating IBNR reserves, provisions for economic inflation and changes in the social and legal environment are considered, but involve considerable judgment.

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

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

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

matures. Management believes that the actuarial methods utilized adequately provide for loss development. Management does not build in a provision for uncertainty outside of the estimates prepared by the Company's actuaries.

The Company's net unpaid loss and loss expense general and financial reserves broken down by operating segment and line of business at December 31, 2005 were as follows:

(U.S. dollars in millions)	December 31, 2005
Insurance	$ 9,860
Reinsurance	7,212
Financial products and services	283
Net unpaid loss and loss expense reserves	$ 17,355

(U.S. dollars in millions)	Net Unpaid Losses and Loss Expenses as at December 31, 2005		
	Case Reserves	IBNR Reserves	Total Reserves
Insurance			
Casualty	$ 3,629	$ 4,022	$ 7,651
Property Catastrophe	427	631	1,058
Other Property	563	287	850
Marine & Aviation	167	134	301
Total	**$ 4,786**	**$ 5,074**	**$ 9,860**
Reinsurance General			
Casualty	$ 1,780	$ 2,452	$ 4,232
Property Catastrophe	577	120	697
Other Property	313	510	823
Marine & Aviation	558	109	667
Other	317	476	793
Total	**$ 3,545**	**$ 3,667**	**$ 7,212**
Financial Operations	$ 83	$ 200	$ 283
Total	**$ 8,414**	**$ 8,941**	**$ 17,355**

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

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

IBNR reserves are calculated by the Companys actuaries using standard actuarial methodologies as discussed above. Prior to the year ended December 31, 2003, the outcomes of the Companys actuarial reviews, consistent with historical practice, provided either (i) a single point reserve estimate or (ii) a range of reserve estimates from which the Company selected a best estimate. Since the year ended December 31, 2003, the Company adopted a methodology that provided a single point reserve estimate separately for each line of business and also a range of possible outcomes across each single point reserve estimate. This is discussed further below. As a result, reserve ranges disclosed previously are not comparable to the reserve ranges disclosed herein.

The following table shows the recorded estimate and the high and low ends of the range of reserves for each of the lines of business noted above at December 31, 2005:

(U.S. dollars in millions)	**Recorded**	**High**	**Low**
Casualty Insurance	$ 7,388	$8,059	$6,739
Casualty Reinsurance	4,141	4,705	3,606
Property Catastrophe	914	1,080	758
Other Property	1,724	1,947	1,513
Marine and Aviation Reinsurance and Insurance	1,628	1,852	1,416
Other (1)	1,043	1,141	950
Total	$ 16,838		
Financial Operations	283		
Provision for potential non recoveries	234		
Total	$ 17,355		

(1) Other consists of several products, including accident and health, political risk, surety and bonding.

With the exception of the adverse development associated with the unfavorable conclusion of the independent actuarial process, actual development of recorded reserves as of December 31, 2004 during 2005 was within the estimated reserve range.

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

As shown in the table above and as previously noted, the Company developed a methodology for calculating reserve ranges around its single point reserve estimates for all its lines of business. Similar to VAR (Value At Risk) models commonly used to evaluate risk, the Company modeled a statistical distribution of potential reserve outcomes over a one year run-off period. The Company used the modeled statistical distribution to calculate an 80% confidence interval for the potential reserve outcomes over this one year run-off period. The high and low end points of the ranges set forth in the above table are such that there is a 10% modeled probability that the reserve will develop higher than the high point and a 10% modeled probability that the reserve will develop lower than the low point.

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

Reserve volatility was analyzed for each line of business within each of the Reinsurance and Insurance segments general operations using the Companys historical data supplemented by industry data. These ranges were then aggregated to the lines of business shown above taking into account correlation between lines of business based on a study of the Companys historical data supplemented by industry data. The practical result of the correlation approach to aggregation is that the ranges by line of business disclosed above, are narrower than the sum of the ranges of the

individual lines of business. Similarly, the range for the Companys total reserves in the aggregate, is narrower than the sum of the ranges for the lines of business disclosed above.

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

The Company does not calculate a range for its total net unpaid loss and loss expense reserves as it would not be appropriate to add the ranges for each line of business to obtain a range around the Companys total reserves, because this would not reflect the diversification effects across the Companys various lines of business. The diversification effects result from the fact that losses across the Companys different lines of business are not completely correlated.

The Company writes both short-tail and long-tail lines of business. Short-tail and long-tail describe the time between the receipt of the premium from a policy and the final settlement of any loss incurred under such policy. Short-tail lines include property catastrophe, other property and certain marine and aviation lines where, on average, the settlement period may be up to 24 months. Long-tail lines, on the other hand, include the Companys casualty business in which claims may take up to 30 years to be reported and settled. The increase in the time associated with ultimate settlement of a claim is directly related to an increase in the amount of judgment required to establish loss reserves, especially IBNR reserves.

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

The Companys three types of reserve exposure with the longest tails are:

(1) high layer excess casualty insurance;

(2) casualty reinsurance; and

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

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

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

Reinsurance operations by their nature add further complications to the reserving process, particularly for casualty business written, in that there is an inherent lag in the timing and reporting of a loss event from an insured or ceding company to the reinsurer. This reporting lag creates an even longer period of time between the policy inception

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and when a claim is finally settled. As a result, more judgment is required to establish reserves for ultimate claims in the Company's reinsurance operations.

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

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

Discontinued asbestos and long-tail environment business had been previously written by NAC Re Corp. (now known as XL Reinsurance America Inc.), prior to its acquisition by the Company.

Except for certain workers' compensation and long-term disability liabilities, the Company does not discount its unpaid losses and loss expenses. The Company utilizes tabular reserving for workers' compensation and long-term disability unpaid losses that are considered fixed and determinable. For further discussion see the Consolidated Financial Statements. As noted above, case reserves for the Company's reinsurance general operations are generally established based on reports received from ceding companies. Additional case reserves may be established by the Company to reflect the Company's estimated ultimate cost of a loss. In addition to information received from ceding companies on reported claims, the Company also utilizes information on the pattern of ceding company loss reporting and loss settlements from previous catastrophic events in order to estimate the Company's ultimate liability related to these hurricane loss events. Commercial catastrophe model analyses and zonal aggregate exposures are utilized to assess potential client loss before and after an event. Initial cedant loss reports are generally obtained shortly after a catastrophic event, with subsequent updates received as new information becomes available. The Company actively requests loss updates from cedants periodically for the first year following an event. The Company's claim settlement processes also incorporate an update to the total loss reserve at the time a claim payment is made to a ceding company.

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

Reinsurance Premium Estimates

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

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

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

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

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

The amount premiums receivable related to reinsurance operation amounted to $1.8 billion as at December 31, 2005.

A significant portion of amounts included as premiums receivable, which represent estimated premiums written, net of commissions, are not currently due based on the terms of the underlying contracts. Management reviews the premiums receivable balance at least quarterly and provides a provision for amounts deemed to be uncollectible. The Company recorded a provision for uncollectible premiums receivable at December 31, 2005 of $11.0 million.

Variable Interest Entities and Other Off-Balance Sheet Arrangements

See the discussion of the Company's variable interest entities and other off-balance sheet arrangements in Item 7 of the Company's Form 10-K/A for the year ended December 31, 2005.

Segment Results for the three months ended June 30, 2006 compared to the three months ended June 30, 2005

The Company is organized into four operating segments – Insurance, General Reinsurance, Life and Annuity Reinsurance and Financial Products and Services – in addition to a Corporate segment that includes the general investment and financing operations of the Company. Following changes in executive management responsibilities the Company now considers the Life and Annuity Reinsurance business as a separate operating segment. General operations include property and casualty lines of business.

The Company evaluates the performance of each segment based on underwriting results for general operations, net income from life and annuity operations and contribution from financial operations. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate assets by segment for its general operations. Investment assets related to the Company's life and annuity and financial operations are held in separately identified portfolios. Net investment income from these assets is included in net income from life and annuity operations and contribution from financial operations, respectively.

Insurance

General insurance business written includes risk management and specialty lines. Risk management products are comprised of global property and casualty insurance programs for large multinational companies, including umbrella liability, integrated risk and primary master property and liability coverages. Specialty lines products include directors' and officers' liability, environmental liability, professional liability, aviation and satellite, employment practices liability, marine, equine and certain other insurance coverages including program business. The Company discontinued writing surety business in 2005.

A large part of the Company's casualty insurance business written has loss experience that is low frequency and high severity. As a result, large losses, though infrequent, can have a significant impact on the Company's results of operations, financial condition and liquidity. The Company attempts to mitigate this risk by using strict underwriting guidelines and various reinsurance arrangements.

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30,**		
	2006	**2005**	**% Change**
Gross premiums written	$ 1,372,084	$ 1,414,389	(3.0)%
Net premiums written	1,107,265	1,112,212	(0.4)%
Net premiums earned	1,029,135	1,054,360	(2.4)%
Fee income and other	7,099	(2,916)	NM
Net losses and loss expenses	681,728	676,374	0.8%
Acquisition costs	113,555	119,032	(4.6)%
Operating expenses	157,604	140,261	12.4%
Exchange losses (gains)	46,324	(34,104)	NM
Underwriting profit	$ 37,023	$ 149,881	(75.3)%

* NM Not Meaningful

Gross and net premiums written decreased by 3.0% and 0.4%, respectively, in the three months ended June 30, 2006 compared with the three months ended June 30, 2005. The decrease in gross premium written was primarily due to continued competitive pressures and price decreases across most non-catastrophe exposed lines, reduced exposures in property and marine and offshore energy business, and the discontinuation of the segment's surety business. Decreases were partially offset by increased volume in professional lines. The decrease in net premiums written compared to the same period in 2005 was in line with that of gross premiums due to lower net retentions in certain lines of business combined with returned ceded premiums associated with a professional lines commutation.

Net premiums earned decreased by 2.4% in the three months ended June 30, 2006 compared with the three months ended June 30, 2005. The decrease was due to the factors affecting net premiums written noted above. The ceded premium impact of the commutation noted above increased net premium earned by $65.0 million in the current quarter.

Exchange losses in the three months ended June 30, 2006 were primarily due to the impact of the strengthening of the U.K. Sterling, Euro, and Swiss Franc against the U.S. dollar during the quarter on Euro and U.K. Sterling loss reserves in units with U.S. dollar functional currencies.

The following table presents the ratios for this segment:

	(Unaudited) Three Months Ended June 30,

	2006	2005
Loss and loss expense ratio	66.2%	64.2%
Underwriting expense ratio	26.4%	24.5%
Combined ratio.	92.6%	88.7%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss and loss expense reserves held at the beginning of the year. The loss ratio for the three months ended June 30, 2006 increased compared with the three months ended June 30, 2005, primarily due to loss ratios recorded on current quarter business earned being slightly higher than prior year because of recent price reductions and the impact of losses recaptured upon the commutation, noted above. The three months ended June 30, 2006 included only approximately $2.0 million in net prior period reserve strengthening.

The increase in the underwriting expense ratio in the three months ended June 30, 2006 compared to the same period in 2005 was due primarily to an increase in the operating expense ratio of 1.9 points (15.3% as compared to 13.4%). The increase in the operating expense ratio was due primarily to increased compensation costs compared to the same quarter in the prior year, combined with the reduction in net earned premiums described above.

Reinsurance

Reinsurance General Operations

General reinsurance business written includes casualty, property, marine, aviation and other specialty reinsurance on a global basis. The Companys reinsurance property business generally has loss experience characterized as low frequency and high severity, which can have a negative impact on the Companys results of operations, financial condition and liquidity. The Company endeavors to manage its exposures to catastrophic events by limiting the amount of its exposure in each geographic zone worldwide and requiring that its property catastrophe contracts provide for aggregate limits and varying attachment points.

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30,**		
	2006	**2005**	**% Change**
Gross premiums written	$ 582,353	$ 506,250	15.0%
Net premiums written	439,664	347,492	26.5%
Net premiums earned	671,871	673,201	(0.2)%
Fee income and other	(2,109)	(463)	NM
Net losses and loss expenses	372,613	568,154	(34.4)%
Acquisition costs	159,485	149,049	7.0%
Operating expenses	45,077	38,153	18.1%
Exchange (gains) losses	(21,083)	21,895	NM
Underwriting profit (loss)	$ 113,670	$ (104,513)	NM

* NM Not Meaningful

Gross and net premiums written increased by 15.0% and 26.5%, respectively, in the second quarter of 2006 as compared to the second quarter in 2005. The growth in gross premiums written was due primarily to certain premium adjustments of $54.7 million in the current quarter related to prior underwriting years. Net premiums written reflected the above changes in gross premiums written combined with the new catastrophe reinsurance agreement with Cyrus Reinsurance Limited and timing changes on certain segment reinsurance programs.

Net premiums earned in the second quarter of 2006 decreased 0.2% as compared to the second quarter of 2005. This decrease is a reflection of the premium adjustments noted above as well as an overall reduction of net premiums written over the last 24 months.

The following table presents the ratios for this segment:

	(Unaudited) Three Months Ended June 30,	
	2006	2005
Loss and loss expense ratio	55.5%	84.4%
Underwriting expense ratio	30.4%	27.8%
Combined ratio.	85.9%	112.2%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss reserves held at the beginning of the year. The decrease in the loss and loss expense ratio in the three months ended June 30, 2006, compared to the same three months ended in 2005, primarily reflected adverse prior year development relating to North American Reinsurance operations of $190.6 million recorded in 2005. This increase resulted from the Company's scheduled semi-annual 2005 reserve review. There was limited development as noted below resulting from the 2006 review. Net prior year loss development represented a release of $20.9 million during the quarter ended June 30, 2006. This development consists of $42.9 million adverse development on the 2005 hurricanes, which was more than offset by $63.8 million favorable development on the remainder of the portfolio. This compares to $157.6 million in total net adverse development in the second quarter of 2005.

The $63.8 million favorable development experienced in the quarter is comprised of $12.8 million adverse on Casualty lines more than offset by $76.6 million favorable on non-casualty lines, primarily property risk. The casualty development includes adverse on a specific Workers' Compensation program written in our North American Reinsurance operations and deterioration on claims related to Enron, partially offset by favorable developments on Medical Malpractice. Professional lines continue to develop within expectations.

The increase in the underwriting expense ratio in the three months ended June 30, 2006, as compared with the three months ended June 30, 2005, was due to increases in the both acquisition expense ratio and operating expense ratio to 23.7% and 6.7%, respectively, as compared to 22.1% and 5.7%, respectively, in the second quarter of 2005. The increase in the acquisition expense ratio was due to increased profit commissions that resulted from favorable loss development compared to prior periods. The operating expense ratio increase was primarily due to compensation expenses.

Exchange gains in the three months ended June 30, 2006 were mainly attributable to an overall weakening, during the quarter, in the value of the U.S. dollar against U.K. Sterling and the Euro in those operations with U.S. dollar as their functional currency and net U.K. sterling and Euro assets.

Reinsurance – Life and Annuity Operations

Life business written by the reinsurance operations is primarily European life reinsurance. This includes term assurances, group life, critical illness cover, immediate annuities and disability income business. Due to the nature of these contracts, premium volume may vary significantly from period to period. In addition, certain closed block U.S. life and annuity reinsurance contracts previously included in the Financial Products and Services segment are now included in the Reinsurance segment as management of these contracts was transferred to the traditional life reinsurance business units in 2005 in order to centralize management of mortality-based life and annuity reinsurance business.

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30,**		
	2006	**2005**	**% Change**
Gross premiums written	$ 189,174	$ 1,942,748	(90.3)%
Net premiums written	179,678	1,933,008	(90.7)%
Net premiums earned	179,894	1,933,215	(90.7)%
Fee income and other	128	114	12.3%
Claims and policy benefits	232,453	2,020,664	(88.5)%
Acquisition costs	12,279	35,058	(65.0)%
Operating expenses	5,446	5,068	7.5%
Exchange (gains) losses	(2,864)	403	NM
Net investment income	85,371	71,963	18.6%
Net income (loss) from life and annuity operations	$ 18,079	$ (55,901)	NM

* NM Not Meaningful

Gross and net premiums written as well as net premiums earned and claims and policy benefits decreased significantly in the second quarter of 2006 as compared to the second quarter of 2005. These decreases were primarily the result of a large U.K. immediate annuity portfolio contract written in the second quarter of 2005, representing $1.8 billion in net premiums written and earned. The underlying portfolio of installment premium term assurance business continues to grow predominantly in the U.K. and Europe. Ceded premiums remained consistent with the prior year.

Claims and policy benefits also decreased significantly as a result of the annuity payout liabilities assumed under the contract noted above during 2005. Changes in claims and policy benefits also include the movement in policy benefit reserves related to other contracts where investment assets were acquired with the assumption of the policy benefit reserves at the inception of the contract. In addition, during the second quarter of 2005, $37.4 million in claims and policy benefits were recorded related to certain novated blocks of U.S.-based term-life mortality reinsurance business as a result of the actuarially modeled impact of actual paid losses being greater than expected, which were not repeated in 2006.

Acquisition costs decreased in the second quarter of 2006, as compared to the second quarter of 2005, due to the write-off of certain deferred costs related to the U.S. mortality business of $25.9 million, which took place in the second quarter of 2005 as then current profit projections did not support the recovery of deferred costs. Operating expenses increased in the second quarter of 2006 compared to the same period in 2005, reflecting reduced compensation costs offset by increased corporate allocations and the start-up costs of new life operations in the U.S.

Net investment income is included in the calculation of net income from life and annuity operations, as it relates to income earned on portfolios of separately identified and managed life investment assets and other allocated assets. The continued build-up of the business has significantly increased the invested assets relating to these operations since 2005.

Financial Products and Services

Financial Products and Services provides (i) financial guaranty insurance and reinsurance, (ii) a wide range of structured financial and alternative risk transfer products, (iii) municipal investment and funding agreements, (iv) political risk insurance, and (v) weather and energy risk management products. Many of the products offered by Financial Products and Services are unique and tailored to the specific needs of the insured or user.

Financial guaranty insurance and reinsurance generally guarantees payments of interest and principal on an issuer's obligations when due. Obligations guaranteed or enhanced by the Company range in duration and premiums are received either on an installment basis or upfront. Guaranties written in credit default swap form provide coverage for losses upon the occurrence of specified credit events set forth in the swap documentation.

Structured financial and alternative risk transfer products cover complex financial risks, including property, casualty and mortality insurance and reinsurance, and business enterprise risk management products

Municipal investment contracts and funding agreements provide users guaranteed rates of interest on amounts deposited with the Company. 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 its estimated ultimate liability on such agreements.

Political risk insurance generally covers risks arising from expropriation, currency inconvertibility, contract frustration, non-payment and war on land or political violence (including terrorism) in developing regions of the world. Political risk insurance is typically provided to financial institutions, equity investors, exporters, importers, export credit agencies and multilateral agencies in connection with investments and contracts in emerging market countries.

The Companys weather and energy risk management products are customized solutions designed to assist corporate customers, primarily energy companies and utilities, to manage their financial exposure to variations in underlying weather conditions and related energy markets. The following table summarizes the contribution for this segment:

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30, 2006**	**2005**	**% Change**
Gross premiums written	$ 152,570	$ 102,450	48.9%
Net premiums written	148,220	100,386	47.7%
Net premiums earned	103,690	51,992	99.4%
Fee income and other	1,512	217	NM
Net losses and loss expenses	65,220	17,179	279.6%
Acquisition costs	10,193	7,849	29.9%
Operating expenses	20,399	17,338	17.7%
Exchange losses	316	1,113	(71.6)%
Underwriting profit	$ 9,074	$ 8,730	3.9%
Net investment income financial guarantee	$ 18,323	$ 14,986	22.3%
Net investment income structured products	108,487	70,725	53.4%
Interest expense structured products	80,521	54,134	48.7%
Operating expenses structured products	11,625	13,439	(13.5)%
Net income (losses) from financial and investment affiliates	12,255	(7,437)	NM
Minority interest		2,300	NM
Net results from derivatives	3,887	17,487	(77.8)%
Net contribution from financial operations	$ 59,880	$ 34,618	73.0%

* NM Not Meaningful

Gross and net premiums written relating to the financial guaranty line of business reflect premiums received and accrued for in the periods presented and do not include the present value of future cash receipts expected from financial guaranty installment premium policies and contracts written in the period. In addition to financial guaranty premiums, segment premiums also include premiums received from political risk and other structured property and casualty business lines. Increases in gross and net premiums written of 48.9% and 47.7%, respectively, in the second quarter of 2006, as compared to the comparable period in 2005 were primarily due to additional premiums written as a result of losses reported and a change of control cancellation of a structured property and casualty reinsurance contract. In addition, the financial guarantee business reported continued growth in its public finance in-force portfolio.

Net premiums earned increased in the second quarter of 2006, as compared to the same period in 2005. The increase primarily resulted from earnings attributable to the additional premium written relating to the structured property and casualty reinsurance contract discussed above, as well as to earnings from the early termination of certain financial guaranty insurance contracts (e.g. as a result of issuers refinancing such obligations).

The following table provides a line of business breakdown of the Financial Products and Services segments net premiums earned:

(U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30,		
	2006	2005	% Change
Financial Guaranty	$59,794	$40,850	46.4%
Political Risk	9,578	6,352	50.8%
Other (1)	34,318	4,790	NM

(1) Includes structured financial and alternative risk transfer products and weather and energy risk management products

* NM Not Meaningful

Net losses and loss expenses include current year net losses incurred and adverse or favorable development of prior year net loss and loss expense reserves. Net losses and loss expenses for the three months ended June 30, 2006 increased by 279.6% compared to the three months ended June 30, 2005. This increase was primarily a result of adverse development on 2005 hurricane losses and a structured property and casualty contract of aggregating $26.0 million, as well as an increase of $28.0 million in a case reserve on a structured finance transaction which guaranteed a certain amount of revenue from a pool of equipment leases. The second quarter of 2005 included approximately $9.5 million of net provisions for case reserves related to certain financial guaranty contracts, as well as a provision for unallocated reserves on our financial guaranty business of approximately $2.4 million.

For the three months ended June 30, 2006, acquisition costs as a percentage of net premiums earned decreased as compared to the same period in 2005 as there were no acquisition costs associated with the additional premiums earned discussed above.

Operating expenses increased in the second quarter of 2006, as compared to the second quarter of 2005, due to increases in certain segment management costs.

Net investment income related to the financial guaranty business increased by 22.3% in the three months ended June 30, 2006, as compared to the same period in 2005, due primarily to higher average invested assets resulting from net cash inflows from operations combined with higher yields on new investments during the three months ended June 30, 2006.

Net investment income related to structured products increased by 53.4% in the three months ended June 30, 2006, as compared to the same period in 2005, primarily as a result of significant increases in the combined average funding agreement and guaranteed investment contract balances from $4.7 billion to $5.9 billion for the three months ended June 30, 2005 and 2006, respectively, together with increased yields.

Interest expenses on structured products relate to the accretion charges on deposit liabilities related to funding agreements, guaranteed investment contracts and certain structured insurance and reinsurance contracts. The increase in interest expense during the three months ended June 30, 2006, as compared to the same period in 2005, related primarily to the increase in the combined average funding agreement and guaranteed investment contract balances for the three months ended June 30, 2006, as compared to the period in 2005.

Net results from derivatives represent changes in the market value of the Companys insured credit derivative portfolio, weather and energy derivative instruments and certain structured derivatives. The net results from derivatives for the three months ended June 30, 2006 primarily related to small gains on certain weather derivatives and a larger gain in 2005, related to the early termination of a structured derivative product tied to appreciation in a housing price index.

Net income from financial and investment affiliates include earnings on the Company’s investment in Primus Guaranty, Ltd (“Primus”) and certain of the Company’s investment affiliates. The increase in the second quarter of 2006, as compared to the second quarter of 2005, was due primarily to increased earnings from Primus. Primus specializes in providing credit risk protection through credit derivatives. Primus had a positive mark-to-market adjustment in the quarter related to such derivatives.

Investment Activities

The following table illustrates the change in net investment income from general operations, net income (loss) from investment affiliates, net realized gains (losses) on investments and net realized and unrealized gains (losses) on investment derivative instruments for the three months ended June 30, 2006 and 2005.

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30,**		
	2006	**2005**	**% Change**
Net investment income general operations	$261,441	$209,727	24.7%
Net income (loss) from investment affiliates general operations	27,800	(7,936)	NM
Net realized (losses) gains on investments	(23,604)	90,055	NM
Net realized and unrealized gains (losses) on investment derivative instruments general operations	25,351	(65,428)	NM

* NM Not Meaningful

Net investment income related to general operations increased 24.7% in the second quarter of 2006 as compared to the second quarter of 2005 due primarily to a higher investment base, as well as increases in the yield of the portfolio. Excluding the non-recurring $28.6 million of income associated with the unwind of a collateralized debt obligation in the second quarter of 2005, the increase in net investment income related to general operations was 44.3%. The growth in the investment base reflected the issuance of ordinary shares and equity units in the fourth quarter of 2005 and the Companys cash flow from operations. The market yield to maturity on the fixed income portfolio was 5.4% at June 30, 2006, as compared to 4.1% at June 30, 2005 due primarily to higher interest rates in the U.S.

Net income from investment affiliates increased in the second quarter of 2006 compared to a net loss for the second quarter of 2005 due primarily to stronger performance in alternative fund affiliates.

The Company manages its investment grade fixed income securities using an asset/liability management framework. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful. Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the investment portfolio returns for the asset/liability portfolios and risk asset portfolios:

	(Unaudited) Three Months Ended June 30, 2006 (1)	**(Unaudited) Three Months Ended June 30, 2005 (1)**
Asset/Liability portfolios		
USD fixed income portfolio	0.6%	2.3%
Non USD fixed income portfolio	0.1%	3.0%
Risk Asset portfolios		
Alternative portfolio (2)	1.5%	(0.7)%

Equity portfolio	(3.2)%	1.3%
High-Yield fixed income portfolio	0.5%	2.9%

(1) Portfolio returns are calculated by dividing the sum of net investment income or net income (loss) from investment affiliates, realized gains (losses) and unrealized gains (losses) by the average market value of each portfolio. Non U.S. dollar fixed income performance is measured in either the underlying currency or in U.S. dollars.

(2) Performance on the alternative portfolio reflects the three months ended May 31, 2006 and May 31, 2005, respectively.

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

Net realized losses on investments in the second quarter of 2006 included net realized losses of $11.3 million from sales of investments and net realized losses of approximately $12.3 million related to the write-down of certain of the Company's fixed income, equity and other investments where the Company determined that there was an other than temporary decline in the value of these investments.

Net realized gains on investments in the second quarter of 2005 included net realized gains of $101.3 million from sales of investments and net realized losses of approximately $11.2 million related to the write-down of certain of the Company's fixed income, equity and other investments where the Company determined that there was an other than temporary decline in the value of those investments.

The Company's process for identifying declines in the fair value of investments that are other than temporary involves consideration of several factors. These factors include: (i) the time period during which there has been a significant decline in value; (ii) an analysis of the liquidity, business prospects and overall financial condition of the issuer; (iii) the significance of the decline; (iv) an analysis of the collateral structure and other credit support, as applicable, of the securities in question; and (v) the Company's intent and ability to hold the investment for a sufficient period of time for the value to recover. Where the Company's analysis of the above factors results in the Company's conclusion that declines in fair values are other than temporary, the cost of the security is written down to fair value and the previously unrealized loss is therefore realized in the period such determination is made.

Net realized and unrealized gains on investment derivatives for the three months ended June 30, 2006, as well as the losses for the corresponding period in 2005, resulted from the Company's investment strategy to hedge certain interest, credit and foreign exchange risks within the investment portfolio.

Net Unrealized Gains and Losses on Investments

At June 30, 2006, the Company had net unrealized losses on fixed income and short term securities of $459.7 million and net unrealized gains on equities of $131.2 million. Of these amounts, gross unrealized losses on fixed income and short term securities and equities were $699.2 million and $12.7 million, respectively. The information presented below for the gross unrealized losses on the Company's investments at June 30, 2006 shows the potential effect upon future earnings and financial position should management later conclude that some of the current declines in the fair value of these investments are other than temporary. U.S., U.K. and the Euro zone interest rates increased during the three months ended June 30, 2006, which was the primary reason for the decline in net unrealized gains on fixed income securities.

At June 30, 2006, approximately 11,400 fixed income securities out of a total of approximately 17,400 securities were in an unrealized loss position. The largest single unrealized loss in the fixed income portfolio was $6.5 million. Approximately 300 equity securities out of a total of approximately 1,700 securities were in an unrealized loss position at June 30, 2006 with the largest individual loss being $1.3 million.

The following is an analysis of how long each of those securities with an unrealized loss at June 30, 2006 had been in a continual unrealized loss position:

(U.S. dollars in thousands)

Type of Securities	**Length of time in a continual unrealized loss position**	**(Unaudited) Amount of unrealized loss at June 30, 2006**	**(Unaudited) Fair Value of Securities unrealized loss position at June 30, 2006**
Fixed Income and Short-Term	Less than six months	$ 204,172	$ 9,112,947
	At least 6 months but less than 12 months	308,829	8,699,510
	At least 12 months but less than 2 years	137,912	4,579,046
	2 years and over	48,251	823,492
	Total	$ 699,164	$ 23,214,995
Equities	Less than six months	$ 9,827	$ 104,176
	At least 6 months but less than 12 months	2,903	40,478
	Total	$ 12,730	$ 144,654

The following is the maturity profile of the fixed income securities that were in a gross unrealized loss position at June 30, 2006:

(U.S. dollars in thousands)

Maturity profile in years of fixed income securities in a continual unrealized loss position	**(Unaudited) Amount of unrealized loss at June 30, 2006**	**(Unaudited) Fair value of securities in unrealized loss positions at June 30, 2006**
Less than 1 year remaining	$ 4,727	$ 838,159
At least 1 year but less than 5 years remaining	130,938	6,570,555
At least 5 years but less than 10 years remaining	175,711	3,885,236
At least 10 years but less than 20 years remaining	38,282	1,874,183
At least 20 years or more remaining	100,198	930,839
Mortgage and asset backed securities	249,308	9,116,023
Total	$ 699,164	$ 23,214,995

The Company operates a risk asset portfolio that includes high yield (below investment grade) fixed income securities. These represented approximately 2.2% of the total fixed income portfolio market value at June 30, 2006. Fair values of these securities have a higher volatility than investment grade securities. Of the total gross unrealized losses in the Company�s fixed income portfolio as at June 30, 2006, $18.1 million related to securities that were below investment grade or not rated. The following is an analysis of how long each of these below investment grade and unrated securities had been in a continual unrealized loss position at the date indicated:

(U.S. dollars in thousands)

Length of time in a continual unrealized loss position	**(Unaudited) Amount of unrealized loss at June 30, 2006**	**(Unaudited) Fair value of securities in unrealized loss position at June 30, 2006**
Less than six months	$ 8,363	$ 414,111
At least 6 months but less than 12 months	7,192	131,319
At least 12 months but less than 2 years	2,233	33,255
2 years and over	278	2,481
Total	$ 18,066	$ 581,166

Other Revenues and Expenses

The following table sets forth other revenues and expenses for the three months ended June 30, 2006 and 2005:

(U.S. dollars in thousands)	**(Unaudited) Three Months Ended June 30,**		
	2006	**2005**	**% Change**
Net income from operating affiliates general operations	$27,810	$18,393	51.2%
Amortization of intangible assets	420	3,043	(86.2)%
Corporate operating expenses	39,313	34,691	13.3%
Interest expense	54,111	43,632	24.0%
Income tax expense	66,437	41,776	59.0%

Net income from operating affiliates was higher for the three months ended June 30, 2006 as compared to the same period in 2005 due to higher income from the Companys investment manager affiliates.

Corporate operating expenses in the three months ended June 30, 2006 increased compared to the three months ended June 30, 2005 primarily reflecting increased compensation costs partially offset by favorable foreign exchange impacts.

The increase in interest expense primarily reflected the increase in outstanding debt since June 30, 2005. For more information on the Companys financial structure, see Liquidity and Capital Resources.

The increase in the Companys income taxes arose principally from the increase in the profitability of the Companys U.S. and European operations.

Segment Results for the six months ended June 30, 2006 compared to the six months ended June 30, 2005

Insurance

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)	**(Unaudited) Six Months Ended June 30,**		
	2006	**2005**	**% Change**
Gross premiums written	$ 2,930,907	$ 3,092,164	(5.2)%
Net premiums written	2,260,430	2,392,362	(5.5)%
Net premiums earned	2,060,432	2,136,878	(3.6)%
Fee income and other	14,494	1,011	NM
Net losses and loss expenses	1,359,235	1,401,889	(3.0)%
Acquisition costs	241,249	257,775	(6.4)%
Operating expenses	295,682	266,129	11.1%

Exchange (gains) losses	77,035	(19,789)	NM
Underwriting profit	$ 101,725	$ 231,885	(56.1)%

* NM Not Meaningful

Gross and net premiums written decreased by 5.2% and 5.5%, respectively, in the six months ended June 30, 2006 compared with the six months ended June 30, 2005. The decrease in gross premiums written was primarily due to corporate risk management initiatives, continued competitive pressures, fewer multi-year contracts, foreign exchange movements and the discontinuation of the segment's surety line of business. These decreases were partially offset by increased volume in professional lines. The decrease in net written premiums as a percentage of gross premiums is primarily a result of decreasing net retentions in certain lines partially offset by the return premium associated with the commutation of a ceded reinsurance policy in professional lines of business.

Net premiums earned decreased by 3.6% in the six months ended June 30, 2006 compared with the six months ended June 30, 2005. The decline in net premium earned is primarily as a result of the earn out of net premiums written in 2005, and the factors impacting gross and net premiums noted above.

Exchange losses in the six months ended June 30, 2006 were primarily due to the strengthening of the U.K. sterling and the Euro against the U.S. dollar during the period.

The following table presents the ratios for this segment:

	(Unaudited) Six Months Ended June 30,	
	2006	**2005**
Loss and loss expense ratio	66.0%	65.6%
Underwriting expense ratio	26.0%	24.5%
Combined ratio.	92.0%	90.1%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss and loss expense reserves held at the beginning of the year. The loss and loss expense ratio for the six months ended June 30, 2006 increased compared with the six months ended June 30, 2005, primarily as a result of higher net adverse development in the same period of the prior year. Prior year net adverse development totaled approximately $16.4 million in the first half of 2006. Net adverse development during the first half of 2005 was $60.0 million largely in professional lines.

The underwriting expense ratio in the six months ended June 30, 2006 increased compared to the same period in 2005, as a result of an increase in the operating expense ratio of 1.9 points (14.4% as compared to 12.5%) partially offset by a lower acquisition expense ratio. The increase in the operating expense ratio was due primarily to increased compensation costs combined with the lower earned premiums.

Reinsurance

Reinsurance General Operations

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30,		
	2006	2005	% Change
Gross premiums written	$ 2,064,908	$ 2,200,452	(6.2)%
Net premiums written	1,728,663	1,915,362	(9.7)%
Net premiums earned	1,306,998	1,356,952	(3.7)%
Fee income and other	817	(446)	NM
Net losses and loss expenses	759,701	978,504	(22.4)%
Acquisition costs	282,524	291,239	(3.0)%
Operating expenses	84,653	79,559	6.4%
Exchange (gains) losses	(17,669)	18,281	NM
Underwriting profit (loss)	$ 198,606	$ (11,077)	NM

* NM Not Meaningful

Gross and net premiums written decreased 6.2% and 9.7%, respectively, in the first half of 2006 as compared to the first half of 2005. This decrease related primarily to the net reduction in catastrophe exposure and restructuring of the Companys marine and energy exposures as a part of the Companys aggregate risk reduction initiatives, partially offset by certain premium adjustments of $54.7 million reflected in the second quarter of 2006. Additionally, selective underwriting in certain motor and casualty lines of business contributed to the decrease. On a net premiums written basis, the decrease largely reflected the significant new catastrophe quota share reinsurance treaty with Cyrus Reinsurance Limited.

Net premiums earned in the first half of 2006 decreased 3.7% as compared to the first half of 2005, due primarily to the earn out of the impact of rate pressures seen in gross premiums written over the last 12 months.

The following table presents the ratios for this segment:

	(Unaudited) Six Months Ended June 30,	
	2006	2005
Loss and loss expense ratio	58.1%	72.1%
Underwriting expense ratio	28.1%	27.3%
Combined ratio	86.2%	99.4%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss reserves held at the beginning of the year. The increase in the loss and loss expense ratio in the six months ended June 30, 2006 compared to the same period in 2005, primarily reflected higher than expected development in the second quarter of 2005 relating to U.S. casualty business of $190.6 million noted above. During the six months ended June 30, 2006, net prior year reserve releases totaled $14.2 million largely in property and professional lines of business.

The increase in the underwriting expense ratio in the first half of 2006 as compared with the first half of 2005, was due to an increase in the operating expense ratio to 6.5%, as compared to 5.9%, in the first half of 2005. Acquisition costs remained flat.

The operating expense ratio increase reflects additional compensation expenses particularly offset by corporate cost reduction efforts.

Exchange gains in the six months ended June 30, 2006 were mainly attributable to an overall weakening in the value of the U.S. dollar against the U.K. Sterling and the Euro in those operations with U.S. dollars as their functional currency and net U.K. Sterling and Euro assets.

Reinsurance Life and Annuity Operations

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)	**(Unaudited) Six Months Ended June 30,**		
	2006	**2005**	**% Change**
Gross premiums written	$ 288,816	$ 2,033,757	(85.8)%
Net premiums written	270,146	2,014,264	(86.6)%
Net premiums earned	270,559	2,014,686	(86.6)%
Fee income and other	194	179	8.4%
Claims and policy benefits	375,333	2,146,291	(82.5)%
Acquisition costs	21,554	41,409	(47.9)%
Operating expenses	11,924	9,251	28.9%
Exchange (gains) losses	(6,238)	673	NM
Net investment income	163,994	131,866	24.4%
Net profit (loss) from life and annuity operations	$ 32,174	$ (50,893)	(163.2)%

* NM Not Meaningful

Gross and net premiums written as well as net premiums earned and claims and policy benefits decreased significantly in the first half of 2006 as compared to the first half of 2005 primarily as a result of several large immediate annuity portfolio contracts bound in the second quarter of 2005. In addition, the underlying portfolio of installment premium term assurance business continues to grow.

Claims and policy benefits also decreased significantly as a result of the annuity payout liabilities accepted under the contracts noted above. Changes in claims and policy benefits also included the movement in policy benefit reserves related to other contracts where investment assets were acquired with the assumption of the policy benefit reserves at the inception of the contract. In addition, during the second quarter of 2005, $37.4 million in losses were recorded related to certain novated blocks of U.S.-based term life mortality reinsurance business as a result of the actuarially modeled impact of actual paid losses being greater than expected.

Acquisition costs decreased in the first half of 2006 as compared to the first half of 2005 reflecting the write-off of certain deferred costs related to the U.S. mortality business during the prior year noted above, as then current profit projections did not support the recovery of the deferred costs product commissions booked in the prior year. Operating expenses increased in the first half of 2006 compared to the same period in 2005 due to build out of existing operations and start-up costs of new life operations in the U.S.

Net investment income increased in the first half of 2006 compared to the first half of 2005 reflecting the increase in life business invested assets primarily arising from new large annuity contracts written since June 30, 2005.

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Financial Products and Services

The following table summarizes the contribution for this segment:

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30, 2006	2005	% Change
Gross premiums written	$ 254,063	$ 163,397	55.5%
Net premiums written	244,526	153,015	59.8%
Net premiums earned	165,150	103,687	59.3%
Fee income and other	4,087	13,368	(69.4)%
Net losses and loss expenses	97,749	24,375	301.0%
Acquisition costs	17,272	14,959	15.5%
Operating expenses	38,682	34,894	10.9%
Exchange (gains) losses	314	1,064	(70.5)%
Underwriting profit	$ 15,220	$ 41,763	(63.6)%
Net investment income financial guarantee	$ 35,400	$ 29,504	20.0%
Net investment income structured products	214,162	132,579	61.5%
Interest expense structured products	158,040	96,544	63.7%
Operating expenses structured products	21,629	23,197	(6.8)%
Net (loss) income from financial and investment affiliates	18,704	(809)	NM
Minority interest	2,258	4,575	(50.6)%
Net results from derivatives	22,815	33,565	(32.0)%
Net contribution from financial operations	$ 124,374	$ 112,286	10.8%

* NM Not Meaningful

Gross and net premiums written relating to the financial guaranty line of business reflect premiums received and accrued for in the period and do not include the present value of future cash receipts expected from financial guaranty installment premium policies and contracts written in the period. In addition to financial guaranty premiums, segment premiums also include premiums received from political risk and other structured property and casualty business lines. Increases in gross and net premiums written of 55.5% and 59.8%, respectively, for the six month period ended June 30, 2006, as compared to the comparable period in 2005, were primarily due to the growth in financial guaranty in-force installment business and several large up front financial guaranty public finance policies written in 2006, as well as additional premiums associated with a structured property and casualty reinsurance contract.

Net premiums earned increased during the six months end June 30, 2006, as compared to the comparable prior year period. The increase primarily resulted from earnings attributable to the additional premium written relating to the structured property and casualty reinsurance contract discussed above, as well as to earnings from the early termination of certain financial guaranty insurance contracts (e.g. as a result of the issuers refinancing such obligations).

The following table provides a line of business breakdown of the Financial Products and Services segments net premiums earned:

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30,		
	2006	2005	% Change
Financial Guaranty	$105,807	$80,457	31.5%
Political Risk	15,607	13,403	16.4%
Other (1)	43,736	9,827	NM

(1) Includes structured financial and alternative risk transfer products and weather and energy risk management products.

* NM Not Meaningful

Net losses and loss expenses include current year net losses incurred and adverse or favorable development of prior year net loss and loss expense reserves. Net losses and loss expenses for the six months ended June 30, 2006 increased by 301.0%, as compared to the comparable period in 2005. This increase was primarily a result of case reserve provisions relating to a structured finance transaction which guaranteed a certain amount of revenue from a pool of equipment leases of $49.5 million combined with hurricane losses on a structured property and casualty contract partially offset by a small decrease in financial guaranty reserves.

For the six months ended June 30, 2006, acquisition costs as a percentage of net premiums earned decreased as there were no acquisition costs relating to the additional earned structural property and casualty premiums discussed above.

Total operating expenses in the six months ended June 30, 2006 were consistent with the same period in 2005.

Net investment income related to financial guaranty business increased by 20.0% in the six months ended June 30, 2006 as compared to the same period in 2005, due primarily to higher invested assets resulting from net cash inflows from operations combined with higher investment yields during the period.

Net investment income related to structured products increased by 61.5% as compared to the same period in 2005 as a result of significant increases in the combined average funding agreement and guaranteed investment contract balances from $4.2 billion to $6.0 billion, combined with increased yields in 2006.

Interest expenses on structured products are comprised of the accretion charges on deposit liabilities related to funding agreements, guaranteed investment contracts and certain structured insurance and reinsurance contracts. The increase in interest expenses in the six months ended June 30, 2006 compared to the same period in 2005 related primarily to the increase in the number of funding agreements noted above, partially offset by reduced interest expenses on certain deposit liabilities resulting from a change in the timing of estimated cash outflows.

Net results from derivatives represent changes in the market value of the Company's insured credit derivative portfolio, weather and energy derivative instruments and certain structured derivatives. The net results from derivatives for the six months ended June 30, 2006 included realized gains from European frost day weather derivative contracts for the 2005/2006 winter, partially offset by negative movements in certain investment grade credit derivative exposures and the amortization of prior mark-to-market gains.

Net income (loss) from financial and investment affiliates includes, earnings on the Company's investment in Primus Guaranty, Ltd ("Primus") and certain of the Company's investment affiliates. The increase in the six months ended June 30, 2006 as compared to the same period in 2005 was due primarily to a large positive mark-to-market during the second quarter of 2006 for Primus combined with continued strong performance of certain investment affiliates.

Investment Activities

The following table illustrates the change in net investment income from general operations, net income from investment affiliates, net realized (losses) gains on investments and net realized and unrealized gains (losses) on investment derivative instruments for the six months ended June 30, 2006 and 2005.

(U.S. dollars in thousands)	**(Unaudited) Six Months Ended June 30,**		
	2006	**2005**	**% Change**
Net investment income – general operations	$523,808	$381,657	37.2%
Net income from investment affiliates – general operations	127,774	59,978	113.0%
Net realized (losses) gains on investments	(839)	150,726	NM

Net realized and unrealized gains (losses) on investment derivative instruments general operations	55,274	(36,328)	NM

* NM Not Meaningful

Net investment income related to general operations increased in the first half of 2006 as compared to the first half of 2005 due primarily to a higher investment base as well as increases in the yield of the portfolio. The growth in the investment base reflected the issuance of ordinary shares and equity units in the fourth quarter at 2005 and the Company's cash flow from operations. The market yield to maturity on the general account portion of the fixed income portfolio was 5.4% at June 30, 2006 as compared to 4.1% at June 30, 2005, due primarily to higher interest rates in the U.S.

Net income from investment affiliates increased in the first half of 2006 compared to the first half of 2005 due primarily to stronger performance in alternative fund affiliates and private equity fund affiliates in the first half of 2006.

The Company manages its investment grade fixed income securities using an asset/liability management framework. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful. Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the investment portfolio returns for the asset/liability portfolios and risk asset portfolios:

	(Unaudited) Six Months Ended June 30, 2006 (1)	(Unaudited) Six Months Ended June 30, 2005 (1)
Asset/Liability portfolios		
USD fixed income portfolio	0.8%	2.3%
Non USD fixed income portfolio	(0.8%)	3.2%
Risk Asset portfolios		
Alternative portfolio (2)	5.9%	2.2%
Equity portfolio	5.1%	0.8%
High-Yield fixed income portfolio	2.4%	1.5%

(1) Portfolio returns are calculated by dividing the sum of net investment income or net (loss) from investment affiliates, realized gains (losses) and unrealized gains (losses) by the average market value of each portfolio. Non U.S. dollar fixed income performance is measured in either the underlying currency or in U.S. dollars.

(2) Performance on the alternative portfolio reflects the six months ended May 31, 2006 and May 31, 2005, respectively.

Net realized and unrealized gains on investment derivatives for the six months ended June 30, 2006, as well as losses for the corresponding period in 2005, resulted from the Company's investment strategy to hedge certain interest, credit and foreign exchange risks within the investment portfolio.

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

Net realized losses on investments in the first six months of 2006 included net realized gains of $22.2 million from sales of investments and net realized losses of approximately $23.0 million related to the write-down of certain of the Company's fixed income, equity and other investments where the Company determined that there was an other than temporary decline in the value of these investments.

Net realized gains on investments in the first six months of 2005 included net realized gains of $184.5 million from sales of investments and net realized losses of approximately $33.8 million related to the write-down of certain of the Company's fixed income, equity and other investments where the Company determined that there was an other than temporary decline in the value of those investments.

Other Revenues and Expenses

The following table sets forth other revenues and expenses for the six months ended June 30, 2006 and 2005:

(U.S. dollars in thousands)	**(Unaudited) Six Months Ended June 30, 2006**	**2005**	**% Change**
Net income from operating affiliates general operations	$ 20,360	$ 33,615	(39.4)%
Amortization of intangible assets	1,515	5,836	(74.0)%
Corporate operating expenses	88,455	83,076	6.5%
Interest expense	104,461	89,508	16.7%
Income tax expense	133,073	94,650	40.6%

Net income from operating affiliates for the six months ended June 30, 2006 decreased by 39.4% compared to the same period in 2005. This decrease related primarily to the impairment in value of certain operating affiliates during the first quarter of 2006.

Corporate operating expenses in the six months ended June 30, 2006 increased compared to the six months ended June 30, 2005 due to certain increased compensation costs partially offset by favorable foreign exchange movements.

The increase in interest expense primarily reflected the increase in outstanding debt since June 30, 2005. For more information on the Companys financial structure, see Liquidity and Capital Resources.

The increase in the Companys income taxes arose principally from an improvement in the profitability of the Companys U.S. and European operations.

Investments

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and to build book value for the Company over the longer term. The strategy strives to maximize investment returns while taking into account market and credit risk. The Companys overall investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance.

At June 30, 2006 and December 31, 2005, total investments, cash and cash equivalents and net payable for investments purchased were $41.0 billion and $41.2 billion, respectively. The following table summarizes the composition of the Companys total investments and cash and cash equivalents:

(U.S. dollars in thousands)	**(Unaudited) Market Value at June 30, 2006**	**Percent of Total**	**Market Value at December 31, 2005**	**Percent of Total**
Cash and cash equivalents	$ 2,566,768	6.3%	$ 3,693,475	9.0%
Net payable for investments purchased	(450,548)	(1.1)%	(639,034)	(1.6)%
Short-term investments	2,772,074	6.8%	2,546,073	6.2%

Fixed maturities	32,792,886	80.0%	32,309,565	78.4%
Equity securities	838,364	2.0%	868,801	2.1%
Investments in affiliates	2,021,256	4.9%	2,046,721	5.0%
Other investments	442,797	1.1%	399,417	0.9%
Total investments and cash and cash equivalents	$ 40,983,597	100%	$ 41,225,018	100%

The Company reviews, on a regular basis, its corporate debt concentration, credit quality and compliance with established guidelines. At June 30, 2006 and December 31, 2005, the average credit quality of the Company's total fixed income portfolio was "AA". Approximately 54.4% of the fixed income portfolio was rated "AAA" by one or more of the principal ratings agencies. Approximately 2.2% was below investment grade or not rated.

Unpaid Losses and Loss Expenses

The Company establishes reserves to provide for estimated claims, the general expenses of administering the claims adjustment process and for losses incurred but not reported. These reserves are calculated using actuarial and other reserving techniques to project the estimated ultimate net liability for losses and loss expenses. The Company's reserving practices and the establishment of any particular reserve reflects management's judgment concerning sound financial practice and do not represent any admission of liability with respect to any claims made against the Company.

Unpaid losses and loss expenses relates primarily to the casualty insurance and reinsurance business written by the Company. The balance was $17.6 billion at June 30, 2006, and $17.4 billion at December 31, 2005.

The table below represents a reconciliation of the Company's unpaid losses and loss expenses for the six months ended June 30, 2006:

(U.S. dollars in thousands)	**(Unaudited) Gross unpaid losses and loss expenses**	**(Unaudited) Unpaid losses and loss expenses recoverable**	**(Unaudited) Net unpaid losses and loss expenses**
Balance as at December 31, 2005	$ 23,767,672	$ (6,412,648)	$ 17,355,024
Losses and loss expenses incurred	2,738,295	(521,610)	2,216,685
Losses and loss expenses paid /recovered	978,442	(769,713)	2,208,729
Foreign exchange and other	205,975	31,663	237,638
Balance as at June 30, 2006	$ 23,733,500	$ (6,132,882)	$ 17,600,618

While the Company reviews the adequacy of established reserves for unpaid losses and loss expenses regularly, no assurance can be given that actual claims made and payments related thereto will not be in excess of the amounts reserved. In the future, if such reserves develop adversely, such deficiency would have a negative impact on future results of operations. See "Unpaid Losses and Loss Expenses" in Item 1, "Critical Accounting Policies and Estimates" in Item 7 and Item 8, Note 9 to the Consolidated Financial Statements, each in the Company's Form 10-K/A for the year ended December 31, 2005, for further discussion.

Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable

As a significant portion of the Company's net premium written incepts in the first six months ended of the year, certain assets and liabilities have increased at June 30, 2006 compared to December 31, 2005. This includes deferred acquisition costs, unearned premiums, premiums receivable and prepaid reinsurance premiums.

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. While reinsurance agreements are designed to limit the Company's losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve the Company of its ultimate liability to its insureds. Accordingly, the loss and loss expense reserves on the balance sheet represent the Company's total unpaid gross losses. Unpaid losses and loss expenses recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

Unpaid losses and loss expenses recoverables were $6.3 billion at June 30, 2006 and $6.6 billion at December 31, 2005. The table below presents the Company's net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable at June 30, 2006 and December 31, 2005.

(U.S. dollars in thousands)	(Unaudited) June 30, 2006	December 31, 2005
Reinsurance balances receivable	$ 1,046,991	$ 1,069,402
Reinsurance recoverable on future policy benefits	15,954	28,874
Unpaid losses and loss expenses recoverable	6,341,949	6,646,972
Bad debt reserve on unpaid losses and loss expenses and reinsurance balances recoverable	(229,561)	(260,713)
Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable	$ 7,175,333	$ 7,484,535

Under the terms of the Sale and Purchase Agreement (the SPA), as amended, between XL Insurance (Bermuda) Ltd (XLI) and Winterthur Swiss Insurance Company (WSIC), WSIC provided the Company with post-closing protection determined as of June 30, 2004 with respect to, among other things, adverse development of reserves and premium on certain Winterthur International Insurance business. This protection was based upon net loss experience and development over a three-year, post-closing seasoning period based on actual loss development experience, collectible reinsurance and certain other factors set forth in the SPA. The SPA included a process for determining the amount due from WSIC by an independent actuarial process whereby the Independent Actuary developed a value of the seasoned net reserves. The actual final seasoned net reserves amount was the submission that was closest to the number developed by the Independent Actuary.

As the Company and WSIC were unable to come to an agreement, the Company submitted to WSIC notice to trigger the independent actuarial process as contemplated by the SPA. On February 3, 2005, both the Company and WSIC made submissions for the independent actuarial process. There were two separate numbers submitted - that for the Seasoned Net Reserves Amount (SNRA) and that for the Net Premium Receivable Amount (NPRA). Subsequent to this date neither party had the opportunity to submit revised figures to the Independent Actuary.

On November 23, 2005 the Company received the draft report from the Independent Actuary in connection with the Companys post-closing protection. The final report was received on December 6, 2005. The Independent Actuarys report concluded that WSIC submitted SNRA and NPRA were closest to the Independent Actuarys determinations of SNRA and NPRA. These determinations resulted in the Company receiving a net lump sum payment in the amount of approximately $575.0 million (including interest receivable) from WSIC. As the Company had recorded $1.4 billion in unpaid losses and loss expenses recoverable related to this protection, a loss of approximately $834.2 million was recorded in the fourth quarter of 2005.

As noted above the independent actuarial process followed a baseball-type arbitration whereby there were only two possible outcomes, not a range of outcomes. The nature of the process was that the final SNRA was either the SNRA submitted by the Company or the SNRA submitted by WSIC. Accordingly, until the receipt of the Independent Actuarys report in the fourth quarter of 2005, the Companys best estimate was the SNRA it had submitted, as it could only ever have been either that number or the number that WSIC submitted.

For financial statement purposes, at each reporting period end subsequent to the SNRA and NPRA submissions being made in February of 2005, the Company assessed the two possible outcomes regarding the SNRA and after considering any new or changed information arising from the process, determined whether it continued to be probable that the Companys SNRA would become the final SNRA as a result of the Independent Actuarial process. If at any time during the process management had concluded, based on the then current information, that the Independent Actuary would calculate an SNRA closer to WSICs SNRA submission, then a loss amounting to the entire difference between the two values would have been recorded. Management did not conclude that this was appropriate at any time prior to the receipt of the Independent Actuarys draft report on November 23, 2005. Specifically, during the third quarter of 2005, further detailed internal analysis was conducted by management to re-evaluate the probability that the Company would be successful in the Independent Actuarial process. All areas where there was a potential that WSICs SNRA submission may have been accepted over the Company's were examined, effectively estimating a reasonable worst-case scenario outcome from the Company's point of view. This was compared to the midpoint of the difference between the two submissions. Management continued to believe the Company would be successful in the process.

There were many individual differences between the Independent Actuarys calculation of the SNRA and that of the Company attributable to different judgment calls, different actuarial methodologies and sources of data. These related primarily to the following five areas:

(i) The Independent Actuary made downwards and upwards adjustments to the Companys established case reserves and then used the revised reserves as source data for his actuarial analysis and the related calculation of the resultant IBNR. The Companys established case reserves previously had been reviewed both internally and by independent claims analysts (which were outside legal counsel in most instances).

(ii) The Independent Actuary selected projection methodologies different than the Companys. Most significantly the Independent Actuarys weighting of paid loss projection versus incurred loss projection was different from the Companys which gave rise to differing conclusions regarding future loss development. The Company continues to believe that its methodology, which was adopted by in-house actuaries and reviewed by both outside actuaries and included in the financial statements audited by the Companys outside auditors, is appropriate and has not changed its loss projections based on the Independent Actuarys report. The methodology used by the Companys actuaries for these reserves is consistent with that used by the Companys actuaries for similar risks written in other business units of the Company.

(iii) The Independent Actuary adopted a methodology different from that of the Company to estimate the application of reinsurance treaties against loss reserves across underwriting years and types of business.

(iv) The conversion into U.S. dollars of the underlying reserve development in local currency between July 2001 and June 2004 also generated a difference. The impact of the decrease in the value of the U.S. dollar on the Independent Actuarys lower levels of local currency adverse development was to increase the difference between XL and the Independent Actuary in U.S. dollars. This was an issue peculiar to the interpretation of the SPA and does not affect the conversions of the loss reserves under U.S. GAAP.

(v) The Independent Actuary made different assumptions than the Company regarding the classification of data used in the actuarial analysis. For example, the Independent Actuary characterized losses as large losses for purposes of separate treatment in his actuarial analysis at a level that was different from the Company. The Companys loss reserves and actuarial methodologies were reviewed both internally and externally by outside actuaries and included in the financial statements audited by the Companys outside auditors.

The differences between the Independent Actuarys and the Companys evaluations of the factors described above were the result of the application of judgments in, the application of actuarial methodology, assessment of loss on individual claims events and/or interpretation of the provisions of the SPA. Because these factors are interdependent, quantification of a single factors individual contribution to the overall difference is not always possible. The quantification of certain reasonably discrete items has been given below. The Companys loss reserves and actuarial methodologies were reviewed both internally and externally by outside actuaries and claims analysts throughout the seasoning period up to the date of our submission to the Independent Actuary and thereafter. Any adjustments to the underlying carried reserves (both upward and downward) since that date have been the result of new information and have been recorded in the period during which the information became available. In particular during our ongoing assessments of unpaid losses in 2005 it was noted that in certain instances reported experience indicated that the distribution of gross losses to existing reinsurance treaties had developed such that net losses were reduced by approximately $90 million. In addition certain claim settlements and new claim emergence resulted in positive development of approximately $110 million as required by the application of actuarial methodologies on a basis consistent with historical practices. As a result, changes in estimates were recorded as the new information and other developments became available contributing to the net positive development for global risk lines of business during 2005 noted in Managements Discussion and Analysis of Financial Condition and Results of Operations. These developments did not change the Companys assessment of the outcome of the Independent Actuarial process.

The difference between the independent actuarys conclusion on the Net Premium Receivable Amount (NPRA) and that of the Company related almost exclusively to an interpretation of the SPA with respect to the application of certain accruals for premiums payable at the closing of the purchase in 2001. The Company accordingly has not made any adjustment to its current premiums receivable balances.

The losses resulting from the determinations of the Independent Actuary were recorded in the fourth quarter of 2005 as it was at this time that the draft and final reports of the Independent Actuary were released and sufficient new information was available to support recording a loss for uncollectible reinsurance based on the baseball-type arbitration which allowed for only one of two outcomes. At no time before the release of that report did the Company believe that recognition of a loss under FAS 5 was appropriate.

Under FAS 5, paragraph 8, a loss contingency shall be accrued to income if information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact that of the loss. At no time prior to the Company's receipt of the draft actuarial report did this condition exist.

Under the terms of the SPA, WSIC also provided the Company with protection with respect to third party reinsurance receivables and recoverables related to the acquisition of certain Winterthur International insurance operations (the "Winterthur Business").

On June 7, 2006, subsidiaries of the Company, entered into an agreement (the "Agreement") with WSIC. The purpose of this Agreement is to release all actual or potential disputes, claims or issues arising out of or related in any way to: (i) the Liquidity Facility and the Sellers Retrocession Agreements, as well as (ii) subject to certain exceptions, the SPA.

The Agreement further provides for a four-year term, collateralized escrow arrangement (the "Fund") of up to $185 million (plus interest) to protect certain subsidiaries from future nonperforming third party reinsurance related to the Winterthur Business. The Fund has been structured to align the parties' interests by providing for any sums remaining in the Fund at the end of its term to be shared in agreed percentages.

The Agreement replaces the protections provided to the Company from WSIC for reinsurance receivables and recoverables under the Liquidity Facility and Sellers Retrocession Agreements noted above and described in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2005 and the Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.

Liquidity and Capital Resources

As a holding company, the Company's assets consist primarily of its investments in subsidiaries, and the Company's future cash flows depend on the availability of dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries the Company operates in including, among others, Bermuda, the United States, Ireland, Switzerland and the United Kingdom, and those of the Society of Lloyd's and certain contractual provisions. No assurance can be given that the Company or its subsidiaries will be permitted to pay dividends in the future.

The Company and its subsidiaries provide no guarantees or other commitments (express or implied) of financial support to the Company's subsidiaries or affiliates, except for express written financial support provided by XL Insurance (Bermuda) Ltd in connection with the Company's financial guaranty subsidiaries and where other express written guaranty or other financial support arrangements are in place.

Liquidity

Liquidity is a measure of the Company's ability to generate sufficient cash flows to meet the short and long term cash requirements of the Company's business operations.

The Company’s operating subsidiaries provide liquidity in that premiums are generally received months or even years before losses are paid under the policies related to such premiums. Historically, cash receipts from operations, consisting of insurance premiums and investment income, have provided more than sufficient funds to pay losses, operating expenses and dividends to the Company.

New cash from operations was approximately $762.1 million in the first six months of 2006 compared with $3.2 billion in the same period in 2005. New cash in the first six months of 2005 included a large immediate annuity portfolio of $1.8 billion. Net new cash in 2006 was due primarily to higher investment income in the period, offset by payments related to the 2005 hurricanes of approximately $590 million. In addition net cash from structured and spread transactions was negative $784.7 million, substantially due to ordinary course net redemptions in the muni-GIC's and funding agreements.

Capital Resources

At June 30, 2006, the Company had total shareholders’ equity of $8.5 billion. In addition to ordinary and preferred share capital, the Company depends on external sources of financing such as debt, credit facilities and contingent capital to support its underwriting activities.

The Company does not intend, subject to the terms and conditions of the Series A or Series B preference ordinary shares as set forth in the relevant prospectus supplements, to redeem either the Series A or Series B preference ordinary shares unless replaced with capital having at least the equivalent credit.

As at June 30, 2006, the Company had revolving loan facilities from a variety of sources, including commercial banks, totaling $4.6 billion of which $3.4 billion in debt was outstanding. In addition, the Company had letters of credit facilities amounting to $6.1 billion of which $4.1 billion was utilized to provide letters of credit in issue at June 30, 2006, 4.8% of which were collateralized by the Company’s investment portfolio. Such letters of credit principally support the Company’s U.S. non-admitted business and the Company’s capital requirements at Lloyd’s.

Debt

The following table presents the Company’s indebtedness under outstanding debt securities and lenders’ commitments as at June 30, 2006:

				Payments Due by Perio		
Notes Payable and Debt (U.S. dollars in thousands)	**Commitment**	**In Use**	**Year of Expiry**	**Less than 1 Year**	**1 to 3 Years**	**3 to 5 Years**
364-day revolver	$ 100,000	$ —	2006	$ —	$ —	$ —
5 and 3-year revolvers	1,000,000	—	2007/2010	—	—	—
5-year revolver	100,000	—	2010	—	—	—
2.53% Senior Notes	825,000	825,000	2009	—	825,000	—
5.25% Senior Notes	745,000	745,000	2011	—	745,000	—
6.58% Guaranteed Senior Notes	255,000	255,000	2011	—	—	255,000
6.50% Guaranteed Senior Notes	598,237	598,237	2012	—	—	—
5.25% Senior Notes	594,650	594,650	2014	—	—	—
6.375% Senior Notes	350,000	350,000	2024	—	—	—
Total	$ 4,567,887	$ 3,367,887		$ —	$ 1,570,000	$ 255,000

"Commitment" and "In Use" data represent June 30, 2006 accreted values. "Payments Due by Period" data represent ultimate redemption values.

Credit facilities, contingent capital and other sources of collateral.

The Company closed a new $500 million syndicated credit facility on May 9, 2006. The new facility has a tenor of 364-days and is available for letters of credit only.

At June 30, 2006, the Company had eight letter of credit facilities in place with total availability of $6.1 billion, of which $4.1 billion was utilized.

				Amount of Commitment Expiration Per Period			
Other Commercial Commitments (U.S. dollars in thousands)	**Commitment**	**In Use**	**Year of Expiry**	**Less than 1 Year**	**1 to 3 Years**	**3 to 5 Years**	**After 5 Years**
Letter of credit facility	$ 200,000	$ 192,421	Continuous	$ 200,000	$ —	$ —	$ —
2 Letter of credit facilities	5,979	5,979	2006	5,979	—	—	—
Letter of credit facility (1)	100,000	—	2006	100,000	—	—	—
Letter of credit facility	150,000	150,000	2006	150,000	—	—	—
Letter of credit facility	500,000	471,238	2007	500,000	—	—	—
Letter of credit facility	913,250	742,282	2008	—	913,250	—	—
Letter of credit							