

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

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

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

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____
Commission file number 1-10804

XL CAPITAL LTD

(Exact name of registrant as specified in its charter)

Cayman Islands

(State or other jurisdiction of
incorporation or organization)

98-0191089

(I.R.S. Employer Identification No.)

**XL House, One Bermudiana Road
Hamilton, Bermuda HM 11**

(Address of principal executive offices and zip code)

(441) 292-8515

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Class A Ordinary Shares, Par Value \$0.01 per Share	New York Stock Exchange, Inc.
Series A 8.00% Preference Ordinary Shares, Par Value \$0.01 per Share	New York Stock Exchange, Inc.
Series B 7.625% Preference Ordinary Shares, Par Value \$0.01 per Share	New York Stock Exchange, Inc.
6.50% Equity Security Units	New York Stock Exchange, Inc.
7.00% Equity Security Units	New York Stock Exchange, Inc.

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d)

of the Exchange Act. Yes | | No

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

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

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

Large accelerated filer 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

The aggregate market value of the voting common equity of the registrant held by non-affiliates of the registrant on February 27, 2006 was approximately \$12.1 billion computed upon the basis of the closing sales price of the Class A Ordinary Shares on that date. For purposes of this computation, ordinary shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 28, 2006, there were outstanding 179,559,424 Class A Ordinary Shares, \$0.01 par value per share, of the registrant.

Documents Incorporated by Reference

The Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report relating to the annual meeting of ordinary shareholders to be held on April 28, 2006 is incorporated by reference into Part III of this Form 10-K.

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

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (this "Amendment") amends the Annual Report on Form 10-K for the year ended December 31, 2005 filed on March 7, 2006 (the "Original Filing"). XL Capital Ltd has filed this Amendment to correct certain errors in the Consolidated Statements of Cash Flows as described in Note 29 of the Notes to the Consolidated Financial Statements, *Restatement of Consolidated Statements of Cash Flows*, as well as to make corresponding textual changes in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations and to add related information in Item 9A, 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

ITEM 1. BUSINESS

History

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

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

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

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

Effective January 1, 2002, the Company increased its shareholding in Le Mans Ré from 49% to 67% in order to expand its international reinsurance operations. On September 3, 2003, the Company exercised its option to buy the remaining 33% from MMA for approximately \$161 million in cash and changed the name of Le Mans Ré to XL Re Europe. XL Re Europe underwrites a worldwide portfolio comprising most classes of property and casualty reinsurance business, together with a select portfolio of life reinsurance business. See further information under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 5 to the Consolidated Financial Statements.

Segments

The Company operates through three business segments: Insurance, Reinsurance and Financial Products and Services. These business segments were determined in accordance with Statement of Financial Accounting Standard ("FAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("FAS 131"). General, life and annuity and financial operations are disclosed separately within each segment.

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.

The following areas have been changed for all periods presented:

- 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.

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- Political risk insurance business units now report to executive management of the Financial Products and Services segment and, as such, future 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 guaranteed investment contracts and funding agreements, are now reported under financial operations in order to consolidate businesses with similar operating characteristics and risks.
- All 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. Management believes this change better reflects the nature of spread focused business.

The following table sets forth an analysis of gross premiums written by segment for the years ended December 31, 2005, 2004 and 2003. Additional financial information about the Company's segments, including financial information about geographic areas, is included in Item 8, Note 3 to the Consolidated Financial Statements.

Year ended December 31 <i>(U.S. dollars in thousands)</i>	2005 Gross Premiums Written	Percentage Change	2004 Gross Premiums Written	Percentage Change	2003 Gross Premiums Written
Insurance – General	\$ 5,785,750	(2.3)%	\$ 5,924,951	14.1%	\$ 5,193,287
Reinsurance – General	3,411,087	(1.3)%	3,456,511	0.4%	3,443,405
Reinsurance – Life and Annuity	2,274,520	62.8%	1,397,516	90.5%	733,649
Financial Products & Services	378,140	9.5%	345,235	(4.2)%	360,509
	\$ 11,849,497	6.5%	\$ 11,124,213	14.3%	\$ 9,730,850

Insurance Operations

General

The Company provides commercial property and casualty insurance products on a global basis. Products generally provide tailored coverages for complex corporate risks and are divided into two categories: risk management products and specialty lines products.

Risk management products comprise global property and casualty insurance programs for large multinational companies and institutions and include umbrella liability, product recall, U.S. workers' compensation, property catastrophe and primary master property and liability coverages. Risk management products generally provide large capacity on a primary, quota share or excess of loss basis. Risk management products are targeted to large worldwide companies in major industry groups including aerospace, automotive, consumer products, pharmaceutical, pulp and paper, high technology, telecommunications, transportation and basic metals. In North America, casualty business written is generally long-tail, umbrella and high layer excess business, meaning that the Company's liability attaches after large deductibles, including self insurance or insurance from other companies. Primary casualty programs (including workers' compensation) generally require customers to take large deductibles or self-insured retentions. Outside of North America, casualty business is also written on a primary basis. Policies are written on an occurrence, claims-made and occurrence reported basis. The Company's property business written is short-tail by nature and written on both a primary and excess of loss basis. Property business written includes exposures to man-made and natural disasters, and generally, loss experience is characterized as low frequency and high severity. This may result in volatility in the Company's results of operations, financial condition and liquidity. See Item 7, "Management's Discussion and Analysis of Financial

Condition and Results of Operations.□

Specialty lines products include professional liability insurance, environmental liability insurance, aviation and satellite insurance, marine and offshore energy insurance, equine, and other insurance coverages including program business.

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

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

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

Marine and offshore energy and equine insurance are also provided by the Company. Marine and energy coverage includes marine hull and machinery, marine war, marine excess liability, cargo and offshore energy insurance. Equine products specialize in providing bloodstock, livestock and fish farm insurance.

The Company exited the surety business in mid-2005. Prior to that time, business was written on a broad range of surety products and services throughout North America, with a focus on contract, commercial and international trade surety bonds, targeting all segments of the construction marketplace. Surety products included bid, performance, payment, maintenance and supply bonds, commercial surety bonds, U.S. customs and international trade surety bonds, license bonds, permit bonds, court bonds, public official bonds and other miscellaneous bonds.

The Company's program business specializes in insurance coverages for distinct market segments in North America, including program administrators and managing general agents who operate in a specialized market niche and have unique industry backgrounds or specialized underwriting capabilities. Products encompass automobile extended warranty, intellectual property and trademark infringement, small commercial property catastrophe and other property and casualty coverage.

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

U.S. Terrorism

The U.S. Terrorism Risk Insurance Act of 2002, as amended, ("TRIA") became effective on November 26, 2002 and was a three-year federal program effective through 2005. On December 22, 2005, President George Bush

signed a bill extending TRIA for two more years, continuing the program through 2007. TRIA voided in force terrorism exclusions as of November 26, 2002 for certified terrorism acts (i.e., those arising from international, not domestic acts) on all TRIA specified property and casualty business. TRIA requires covered insurers to make coverage available for certified acts of terrorism on all new and renewal policies issued after TRIA was enacted. TRIA allows the Company to assess a premium charge for terrorism coverage and, if the policyholder declines the coverage or fails to pay the buy-back premium, certified acts of terrorism may then be excluded from the policy, subject, however, to state specific requirements. Terrorism coverage cannot be excluded from workers' compensation policies. Subject to a premium-based deductible and provided that the Company has otherwise complied with all the requirements as specified in TRIA, for each year this program is in effect, the Company is eligible for reimbursement by the Federal Government for up to 90% of its covered terrorism-related losses arising from a certified terrorist attack in 2005 and 2006, and up to 85% of such losses in 2007. Such payment by the government will, in effect, provide reinsurance protection on a quota share basis (with the government absorbing 90%, 90% and 85% of the loss and the applicable insurance company absorbing the remaining 10%, 10% and 15% in 2005, 2006 and 2007, respectively). Entitlement to such reimbursement ends once the aggregated insured losses for the entire insurance industry exceed \$100 billion in a single program year. Once this \$100 billion loss threshold has been reached for any program year, any insurer covered under TRIA that has met its deductible will not be responsible for any further loss payments in that program year.

The Company had, prior to the passage of TRIA, underwritten exposures under certain insurance policies that included coverage for terrorism. The passage of TRIA has required the Company to make a mandatory offer of "Certified" terrorism coverage with respect to all of its TRIA covered insurance policies. In addition, the Company underwrites a number of policies providing terrorism coverage that are not subject to TRIA.

Non-U.S. Terrorism

The Company provides coverage for terrorism under casualty policies on a case-by-case basis, except with respect to workers' compensation policies on which no terrorism exclusion of any type is permitted. However, the Company generally does not provide significant limits of coverage for terrorism under first party property policies outside of the U.S. unless required to do so by local law, or as required to comply with any national terrorism risk pool which may be available. Various countries have enacted legislation to provide insurance coverage for terrorism occurring within their borders, to protect registered property, and to protect citizens traveling abroad. The legislation typically requires registered direct insurers to provide terrorism coverage for specified coverage lines and then permits them to cede the risk to a national risk pool. The Company has subsidiaries that participate in terrorism risk pools in various jurisdictions, including Australia, France, Spain, The Netherlands and the United Kingdom.

Underwriting

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

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

risk management quality and other specific risk factors relevant in the judgment of the Company's underwriters to the type of business being written.

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

As the Company's insurance products are primarily specialized coverages, underwriting guidelines and policy forms differ by product offering as well as by legal jurisdiction. Liability insurance is written on both a primary and excess of loss basis, on occurrence, occurrence reported and claims-made policy forms. Occurrence reported policies typically cover occurrences causing unexpected and unintended personal injury or property damage to third parties arising from events or conditions that commence at or subsequent to an inception date, or retroactive date, if applicable (but not prior to January 1, 1986), and prior to the expiration of the policy provided that proper notice is given during the term of the policy or the discovery period. Traditional occurrence coverage is also available for restricted classes of risk and is generally written on a follow-form basis where the policy adopts the terms, conditions and exclusions of the underlying policy. Property insurance risks are written on a lead or follow-form basis that usually provides coverage for all risks of physical damage and business interruption. Maximum limits are generally subject to sublimits for coverage in critical earthquake zones, where the Company seeks to limit its liability in these areas.

Reinsurance Ceded

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

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

Premiums

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

The following table is an analysis of the insurance segment's gross premiums written, net premiums written and net premiums earned from general operations, by line of business for the year ended December 31, 2005:

<i>(U.S. dollars in thousands)</i>	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Professional liability	\$ 1,630,090	\$ 1,520,642	\$ 1,451,183
Casualty insurance	1,678,900	1,139,402	1,081,994
Property catastrophe	157,492	69,120	57,027
Other property	907,568	594,433	557,080
Marine, energy, aviation and satellite	1,018,223	741,050	739,841
Accident and health	1,266	1,649	1,692
Other (1)	392,211	181,809	213,880

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Total	<u>\$ 5,785,750</u>	<u>\$ 4,248,105</u>	<u>\$ 4,102,697</u>
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(1) Other includes political risk, surety, bonding, warranty and other lines.

Additional discussion and financial information about the Company's insurance segment is set forth in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 3 to the Consolidated Financial Statements.

Competition

The Company competes globally in the property and casualty insurance markets. Its competitors include the following companies and their affiliates: The ACE Group of Companies (ACE); American International Group, Inc. (AIG); Factory Mutual Global (FMG) for Property only; Hartford Financial Services (Hartford); Lloyd's of London Syndicates (Lloyd's); Munchener Ruckversicherungs-Gesellschaft Aktiengesellschaft (Munich Re); Swiss Reinsurance Company (Swiss Re); The Chubb Corporation (Chubb); St. Paul/Travelers; and Zurich Financial Services Group (Zurich).

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

North America AIG, ACE, Chubb, FMG, Zurich, St. Paul/Travelers, CNA Financial Corporation, Hartford, Factory Mutual Insurance Company, Liberty Mutual Group and Lloyd's.

Europe Allianz Aktiengesellschaft, AIG, FMG, Zurich, AXA, Munich Re, ACE, Lloyd's, Swiss Re and Allgemeine Versicherungs-AG.

Bermuda ACE, Allied World Assurance Company, Axis Capital Group, Max Re Ltd., Endurance Specialty Insurance Ltd (Endurance), Arch Capital Group Ltd and Starr Excess Liability Insurance Co Ltd.

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

Marketing and Distribution

Clients (insureds) are referred to the Company through a large number of international, national and regional brokers, acting as their agents, and captive managers who receive from the insured or ceding company a set fee or brokerage commission usually equal to a percentage of gross premiums. In the past, the Company has also entered into contingent commission arrangements with some intermediaries that provide for the payment of additional commissions based on such variables as production of new and renewal business or the retention of business. In general, the Company has no implied or explicit commitments to accept business from any particular broker and neither brokers nor any other third party have the authority to bind the Company, except in the case where underwriting authority may be delegated contractually to selected program administrators. Such administrators are subject to a financial and operational due diligence review prior to any such delegation of authority and ongoing reviews and audits are carried out as deemed necessary by the Company with the goal of assuring the continuing integrity of underwriting and related business operations. See Item 8, Note 18(a) to the Consolidated Financial Statements for information on the Company's major brokers.

Claims Administration

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

and, where appropriate, advice of counsel. Reserves are also established to provide for the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process.

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

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

Reinsurance Operations

General

The Company provides casualty, property, property catastrophe, marine, aviation, accident and health, and other specialty reinsurance and life and annuity products on a global basis with business being written on both a proportional and non-proportional basis. Business written on a non-proportional basis generally provides for an indemnification by the Company of the ceding company for a portion of the losses on policies in excess of a specified loss amount. For business written on a proportional or "quota share" basis, the Company receives an agreed percentage of the premium and is liable for the same percentage of the incurred losses. The ceding company receives a commission based upon premiums ceded and may also, under certain circumstances, receive a profit commission. Reinsurance may be written on a treaty or facultative basis.

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

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

The Company seeks to manage its reinsurance exposures to catastrophic events by limiting the amount of exposure in each geographic or peril zone worldwide, underwriting in excess of varying attachment points and requiring that its property catastrophe contracts provide for aggregate limits. The Company also seeks to protect its aggregate exposures by peril and zone through the purchase of reinsurance programs. See "Risk Management" for further information.

The Company's property catastrophe reinsurance account is generally "all risk" in nature. As a result, the Company is exposed to losses from sources as diverse as hurricanes and other windstorms, earthquakes, freezing, riots, floods, industrial explosions, fires, and many other potential disasters. In accordance with market practice, the Company's policies generally exclude certain risks such as war, nuclear contamination or radiation. Following the

terrorist attacks at the World Trade Center in New York City, in Washington, D.C. and in Pennsylvania on September 11, 2001 (collectively, "the September 11 event"), terrorism cover, including nuclear, biological and chemical, has also been excluded in many territories and classes. The Company's predominant exposure under such coverage is to property damage.

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

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

Other specialty reinsurance products include energy, fidelity, trade credit and political risk.

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

The Company's accident and health products include accidental death, medical, hospital indemnity and income protection coverage.

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

Life and Annuity

The Company's reinsurance segment also currently includes life reinsurance primarily in respect of European lives, and is developing a U.S. platform. This includes term assurances, group life, critical illness cover, immediate annuities and disability income business. The majority of the business written is on a proportional basis. The Company has also written a few large contracts comprising portfolios of closed blocks of U.K. and European annuities. In relation to certain of these contracts, the Company receives cash and investment assets at the inception of the contract relating to future policy benefit reserves assumed. These contracts are long-term in nature where the expected claims payout period can span thirty to forty years.

Underwriting

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

Other factors assessed by the Company include the reputation of the proposed cedent, the geographic area in which the cedent does business and its market share, a detailed evaluation of catastrophe and risk exposures, and historical loss data for the cedent where available and for the industry as a whole in the relevant regions, in order to

compare the cedent's historical loss experience to industry averages. On-site underwriting reviews are performed where it is deemed necessary to determine the quality of a current or prospective cedent's underwriting operations, with particular emphasis on proportional and working excess of loss placements.

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

Reinsurance Retroceded

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

A full review of the Company's property catastrophe exposures was completed in the spring of 2004 to optimize the economics against the management of such risks. A traditional program incepting between May and July 2004 and renewing annually was put in place to cover these exposures. These covers give protection in various layers and excess of varying attachment points according to territorial exposure. The Company has co-reinsurance retentions within this program. The program was renewed with June and July 2005 inception dates providing similar amounts of total coverage and an additional structure was purchased with restricted territorial scope with an August 2005 inception date.

A new reinsurance program was purchased incepting at January 2005 to provide additional protection for the Company's marine and offshore energy exposures. These covers provide protection in various layers and excess of varying attachment points according to the scope of cover provided. The Company has co-reinsurance participations within this program.

The Company's casualty reinsurance program includes cover for multiple claims arising from three or more risks from a single occurrence or event. This layer was renewed in October 2004 and again in October 2005 with limits of \$25 million excess of \$20 million and covers all business written out of the Company's London and Sydney branches as well as XL Re Europe.

The Company also buys specific reinsurance on its property and aviation portfolios to manage its net exposures in these classes.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 10 to the Consolidated Financial Statements for further information.

Premiums

The following table is an analysis of the reinsurance segment's gross premiums written, net premiums written and net premiums earned from general and life and annuity operations, by line of business for the year ended December 31, 2005:

<i>(U.S. dollars in thousands)</i>	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Professional liability	\$ 346,758	\$ 343,562	\$ 356,937
Casualty	861,113	810,971	858,651
Property catastrophe	481,765	309,293	302,291
Other property	1,008,333	724,837	701,459
Marine, energy, aviation and satellite	241,045	192,445	194,646
Accident and health	23,919	24,293	31,399
Other (1)	448,154	370,605	325,558
	<hr/>	<hr/>	<hr/>
Total general operations	3,411,087	2,776,006	2,770,941
Life and annuity operations	2,274,520	2,236,903	2,237,721
	<hr/>	<hr/>	<hr/>
Total	\$ 5,685,607	\$ 5,012,909	\$ 5,008,662

(1) Other includes political risk, surety, bonding, warranty and other lines.

Additional discussion and financial information about the reinsurance segment is set forth in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Note 3 to the Consolidated Financial Statements.

Competition

The Company competes globally in the property and casualty markets. Its competitors include the following companies and their affiliates: ACE Tempest Reinsurance, Ltd (Tempest); Lloyd's; Munich Re; St. Paul/Travelers; Swiss Re; PartnerRe Ltd; ERC; Transatlantic Reinsurance Company (Transatlantic Re); and Everest Re.

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

North America – General Re Corporation, American Re Corporation, Swiss Re America Corporation, Transatlantic Re, Everest Re Group Ltd, GE Reinsurance Corp., Endurance, and PartnerRe Ltd.

Europe – Munich Re, Swiss Re, Lloyd's, General Cologne Re, SCOR Reinsurance Company, PartnerRe Ltd and ERC Frankona.

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

The Company's major geographical market for its life reinsurance operations is Europe and the main competitors in this market include Reinsurance Group of America, Inc., Munich Re, ERC, General Cologne Re, Swiss Re and Hannover Life Re.

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

Marketing and Distribution

See Insurance Operations "Marketing and Distribution" and Item 8, Note 18(a) to the Consolidated Financial Statements for information in the Company's marketing and distribution procedures and information on the

Company's major brokers. In addition, for life reinsurance operations the majority of business is written directly with the ceding company rather than through a broker.

Claims Administration

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

Financial Products and Services Operations

General

Financial Products and Services provides (i) credit protection through the issuance of financial guaranty insurance policies and credit default swaps, as well as the reinsurance thereof, (ii) a wide range of structured financial and alternative risk transfer products, (iii) guaranteed investment contracts and funding agreements, (iv) political risk insurance and (v) weather and energy risk management products. Many of the products offered by the Financial Products and Services segment are unique and tailored to the specific needs of the insured or user.

Financial guaranty insurance provides an unconditional and irrevocable guaranty to the holder of a debt obligation of full and timely payment of principal and interest. In the event of a default under the obligation, the insurer has recourse against the issuer and/or any related collateral (which is more common in the case of insured asset-backed obligations or other non-municipal debt) for amounts paid under the terms of the policy. Credit default swaps are derivative contracts which offer credit protection relating to a particular security or pools of specified securities. Under the terms of a credit default swap, 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 referenced security. Credit derivatives typically provide protection to a buyer rather than credit enhancement of an issue as in traditional financial guaranty insurance. The Company's underwriting policies restrict the provision of credit protection to obligations or referenced securities that it determines would be of investment-grade quality without the benefit of credit enhancement provided by the Company through the issuance of its insurance policies and credit default swaps. The Company classifies the financial guaranty policies underwritten in four broad categories: asset-backed structured finance, public finance obligations, essential infrastructure project finance transactions and future flow obligations. Each category contains risks and structures that are unique to the underlying obligation. Asset-backed obligations insured or reinsured by the Company are generally issued in structured transactions backed by pools of assets of specified types, such as residential mortgages, auto loans and other consumer receivables, equipment leases and corporate debt obligations, having an ascertainable cash flow or market value. Public finance obligations insured or reinsured consist mainly of general or special obligations of state and local governments, supported by the issuer's ability to charge taxes or fees for specified services or projects. Essential infrastructure project finance obligations underwritten by the Company include projects such as bridges, toll roads, airports and power plants. Future flow obligations are backed by receivables from the future sales of commodities or the processing of payments received by financial institutions.

Structured financial and alternative risk transfer products cover complex financial risks, including property, casualty, mortality insurance and reinsurance and business enterprise risk management products. Refer to XL Financial Solutions below.

Guaranteed investment contracts are customized financial products that offer a guaranteed investment return to the purchaser, generally a municipal entity that raises funds for a particular project and invests such funds pending their drawdown to complete the project. Funding agreements are investment contracts sold to institutional investors. The Company sells funding agreements either directly to qualified institutional buyers or to special purpose entities which, in turn, issue medium term notes to fixed income investors. 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. Through December 31, 2005, the majority of such insurance has been written through a managing general agent, Sovereign Risk Insurance Ltd. ("Sovereign"), in which the Company is a joint venture partner. On January 23, 2006, the Company announced that it would be selling its interest in Sovereign and no longer writing the business produced by it effective February 1, 2006. This transaction is subject to execution of final documentation and regulatory approvals. The in force business written by the Company through January 31, 2006 will be run-off by the Company. The Company's own political risk underwriting team will continue to underwrite such business subsequent to February 1, 2006.

The Company's weather and energy risk management products are customized solutions designed to assist corporate customers, primarily energy companies and utilities, manage their financial exposure to variations in underlying weather conditions and related energy markets. Weather risk management contracts generally average one season (five months) in duration. The Company uses the capital markets to hedge portions of the risks it has underwritten. The Company continued to grow its contingent power generator outage insurance business. The outage insurance product protects utilities so that in the event of a generator failure, the cost of purchasing replacement electricity above a previously established strike price in the power markets is covered. The Company utilizes markets in electricity, but does not actively trade weather or energy derivatives.

Underwriting

The Company has underwriting guidelines for the various products and asset classes comprising its credit enhancement business, which include single and aggregate risk limitations on specified exposures. A credit committee provides final underwriting approval. The Company's underwriting policy is to credit enhance obligations and exposures that would otherwise be rated in lower investment grade categories. The Company's other activities may occasionally structure and underwrite non-investment grade risks.

For the weather and energy business, the Company has seasonal value at risk ("VaR") limits for weather and electricity generator outage exposures.

Individual funding agreements are issued in the context of the overall cash flow structure of the asset/liability portfolio, taking into consideration the impact of each new funding agreement offering on the overall risk position of the Company.

With respect to the guaranteed investment contract business, the Company underwrites the cash flow risks associated with each contract and continually monitors each contract's performance. The Company utilizes underwriting guidelines to assess risks and internal cash flow and asset liability models to price each contract. The Company focuses on reinvestment opportunities associated with municipal bond issuers.

Reinsurance Ceded

Similar to the Company as a whole, the financial products and services operations utilize outwards reinsurance for single risk and portfolio management purposes. The Company has retroceded risks on a facultative basis to third party reinsurers to provide greater flexibility to manage large single risks and reduce concentrations in specific bond sectors or geographic regions. For the weather and energy risk management business, the Company more often uses derivatives rather than reinsurance to hedge or mitigate its primary exposure, but will use reinsurance as well, if deemed appropriate. For the political risk and structured and alternative risk management businesses, the Company has retroceded certain risks on a facultative basis to reduce overall exposure to large market events.

Premiums

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

	Year ended December 31		
	2005	2004	2003
<i>(U.S. dollars in thousands)</i>			
Financial Guaranty	\$ 173,133	\$ 183,422	\$ 154,133
Political Risk	25,906	27,938	28,886
Other (1)	55,097	17,538	12,325
	254,136	228,898	195,344

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

Additional discussion and financial information about the financial products and services segment is set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 3 to the Consolidated Financial Statements.

Competition

The principal competitors in the municipal and asset-backed insured markets include other triple-A rated and, to a lesser extent, double-A rated monoline financial guarantors and multiline insurance companies and banks. The principal triple-A monoline insurers include MBIA Inc. ("MBIA"), Ambac Financial Group, Inc. ("Ambac"), Financial Guaranty Insurance Company ("FGIC") and Financial Security Assurance Holdings Ltd ("FSA"). There are also many means by which issuers may borrow money without using third party credit enhancement. For example, structured financings may be executed by issuing senior and subordinated tranches of debt that effectively substitute for third party enhancement. Additionally, issuers may raise debt financing by issuing corporate debt or by borrowing from banks. Such alternatives effectively constitute a form of competition for financial guaranty insurance companies.

With respect to the structured and alternative risk management business, competition is encountered from a broad range of multiline reinsurers. Other political risk reinsurers include AIG, Zurich, Chubb and ACE.

With respect to the Company's weather and energy risk management business, competition is encountered in both the U.S. and on a worldwide basis from companies within the energy, insurance and, to an increasing extent, the financial services sector. Among the principal competitive factors affecting the Company's weather and energy business are its financial strength ratings, its capability in originating, marketing, structuring and executing innovative products and services, its relative pricing and its ability and willingness to hedge all or a portion of such risks.

With respect to the Company's guaranteed investment contract business, competitors include financial institutions in the banking, investment banking, life insurance and financial guaranty industries. These include Aegon, AIG, Bayerische Landesbank ("BLB"), Caisse des Depots et Consignations, FSA and MBIA.

Marketing and Distribution

Marketing of the Company's financial guaranty business is targeted based on the type and stage of completion of the transaction. Targeted parties include investment bankers, issuers of and investors in credit-enhanced transactions and concessionaires in certain transactions. Other financial guaranty insurers or reinsurers or other

counterparties may also be a source of new business, particularly with respect to reinsurance.

With respect to the Company's weather and energy risk management business, new clients are acquired through direct marketing but may also be referred through a number of brokers who receive a fee that is based on the size of the transaction. The Company's main clients are in the energy and financial services sector.

Structured and alternative risk management business is principally originated through specialist intermediaries. Clients are the risk managers for corporations as well as the outwards reinsurance teams for a range of geographically diverse insurers. Origination for the political risk book is also primarily through specialist brokers while the client base is financial institutions, equity investors, exporters, importers, export credit agencies and multilateral agencies.

The guaranteed investment contract business is mainly originated through specialized brokers. Funding agreements are typically sold through and distributed by investment banks.

Claims Administration

Claims management for the financial guaranty business includes the identification of potential claims through systematic surveillance of the insured portfolio, the establishment of reserves for losses that are both probable and estimable, the accounting for loss adjustment expenses, the receipt of claims, the approval of claim payments and the notification to reinsurers. Surveillance also involves proactive efforts to prevent or mitigate potential claims once they are identified. If a claim is paid, recoveries will be sought based on the security pledged under the policy.

With respect to the Company's weather and energy business, claims management includes the identification of potential claims through review of underlying weather conditions and unit outages within the insured portfolio, the establishment of reserves for losses that are probable and estimable, loss adjustment expenses, the receipt of claims, the approval of claim payments and the notification of claims to reinsurers.

The majority of the claims management of the political risk business has been handled by Sovereign, with the balance administered internally using the same guidelines as detailed within the Insurance segment operations.

Claims administration and notification for structured and alternative risk business is principally handled by third party administrators, and claims are settled following a review of the claim detail and verification of its validity.

XL Financial Solutions

Structured financial and alternative risk transfer products are structured and managed through the Company's financial solutions operations (XLFS). XLFS structures a wide range of structured financial products and alternative risk transfer transactions, including property and casualty insurance and reinsurance, asset backed securitizations and market risk management transactions. Most transactions originated through XLFS have multi-year exposures, with many transactions having durations in excess of ten years.

Geographic Areas

See Item 8, Notes 3 and 24 to the Consolidated Financial Statements.

Risk Management

The Company seeks to manage all of its risks on an enterprise wide basis. The Company's senior management takes an active role in the enterprise risk management process and has developed and implemented policies and procedures that require specific administrative and business functions to assist in the identification, assessment and management of all current and emerging risks pertaining to the Company's activities including market, credit, underwriting, operational and legal risks. The Company has a Risk Management Committee which in conjunction with the Executive Management Board, acts to ensure major risks are being managed with an enterprise wide perspective. Due to the changing nature of the risk landscape and global marketplace, the Company's risk management policies, procedures and methodologies are constantly evolving and are subject to ongoing review and modification. Senior management provides regular updates on major risk exposures to the Finance and Audit Committee's of the Board of Directors. See Item 7A, Quantitative and Qualitative Disclosures About Market Risk for further discussion.

Aggregate exposures to potential catastrophic events, including natural catastrophes are managed at an entity level and also at the corporate level. In addition to internal controls designed to mitigate the Company's exposure to a

specific event or class of business, the Company maintains various reinsurance programs that help protect the Company against foreseeable catastrophic and other types of risks.

Under its reinsurance security policy, the Company seeks to cede business to reinsurers generally rated "A" or better by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P"), or, in the case of Lloyd's syndicates, "B+" from Moody's Investors Service, Inc. ("Moody's"). The Company's Chief Risk Officer considers reinsurers that are not rated or do not fall within the above rating categories and may grant exceptions to the Company's general policy on a case-by-case basis. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 10 to the Consolidated Financial Statements for further information.

As part of risk management, the Company also has several credit committees and underwriting/transaction committees that meet regularly to review the terms and conditions of certain proposed new transactions.

Unpaid Losses and Loss Expenses

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

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

The nature of the Company's high excess of loss liability and catastrophe business can result in loss payments that are both irregular and significant. Similarly, adjustments to reserves for individual years can be irregular and significant. Such adjustments are part of the normal course of business for the Company. Conditions and trends that have affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it is inappropriate to extrapolate future redundancies or deficiencies based upon historical experience. See generally, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" - Cautionary Note Regarding Forward-Looking Statements.

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

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

(U.S. dollars in
millions)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	
ESTIMATED LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES, NET OF REINSURANCE RECOVERABLES LIABILITY RE-ESTIMATED AS OF:										
One year later	2,885	2,843	3,354	4,016	4,142	4,382	7,404	9,250	10,989	
Two years later	2,546	2,704	3,038	3,564	4,085	4,345	8,423	9,717	12,032	
Three years later	2,445	2,407	2,737	3,580	4,120	5,118	8,653	10,723		
Four years later	2,214	2,227	2,658	3,461	4,624	5,294	9,727			
Five years later	2,050	2,144	2,505	3,742	4,747	5,435				
Six years later	2,010	2,026	2,663	3,774	4,858					
Seven years later	1,915	2,115	2,704	3,872						
Eight years later	1,983	2,146	2,793							
Nine years later	1,981	2,198								
Ten years later	2,020									
CUMULATIVE REDUNDANCY (DEFICIENCY)										
(1)	879	968	816	431	(321)	(1,228)	(2,723)	(2,410)	(1,311)	
CUMULATIVE PAID LOSSES, NET OF REINSURANCE RECOVERIES, AS OF:										
One year later	\$ 445	\$ 234	\$ 458	\$ 812	\$ 1,252	\$ 1,184	\$ 2,011	\$ 2,521	\$ 1,985	\$
Two years later	667	576	932	1,594	1,828	1,920	3,984	3,800	2,867	
Three years later	934	932	1,404	1,928	2,306	2,683	4,703	4,163		
Four years later	1,143	1,235	1,525	2,249	2,824	3,038	4,641			
Five years later	1,356	1,313	1,732	2,555	3,035	3,290				
Six years later	1,408	1,466	1,903	2,741	2,807					
Seven years later	1,485	1,603	2,085	2,856						
Eight years later	1,601	1,749	2,187							
Nine years later	1,674	1,826								
Ten years later	1,716									

(1) See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion.

**Analysis of Consolidated Losses and Loss Expense Reserve Development
Gross of Reinsurance Recoverables**

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(U.S. dollars in
millions)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	
ESTIMATED GROSS LIABILITY FOR UNPAID LOSSES AND LOSS EXPENSES	\$ 3,238	\$ 3,623	\$ 3,972	\$ 4,897	\$ 5,369	\$ 5,668	\$ 11,807	\$ 13,333	\$ 16,763	\$
LIABILITY RE-ESTIMATED AS OF:										
One year later	3,244	3,221	3,763	4,735	5,266	6,118	12,352	15,204	18,399	
Two years later	2,872	3,164	3,496	4,352	5,147	6,105	14,003	16,994	18,730	
Three years later	2,793	2,902	3,243	4,316	5,176	6,909	15,377	17,210		
Four years later	2,572	2,753	3,139	4,232	5,663	7,086	15,441			
Five years later	2,415	2,663	2,979	4,508	5,798	7,240				
Six years later	2,379	2,564	3,132	4,568	5,890					
Seven years later	2,327	2,650	3,181	4,658						
Eight years later	2,393	2,673	3,266							
Nine years later	2,379	2,714								
Ten years later	2,397									
CUMULATIVE REDUNDANCY (DEFICIENCY)	841	909	706	239	(521)	(1,572)	(3,634)	(3,877)	(1,967)	

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

Reconciliation of Unpaid Losses and Loss Expenses

<i>(U.S. dollars in thousands)</i>	2005	2004	2003
Unpaid losses and loss expenses at beginning of year	\$ 19,837,669	\$ 16,763,124	\$ 13,332,502
Unpaid losses and loss expenses recoverable	(6,962,131)	(6,042,505)	(5,019,311)
Net unpaid losses and loss expenses at beginning of year	12,875,538	10,720,619	8,313,191
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:			
Current year	6,351,281	4,643,894	3,759,142
Prior years	1,113,720	267,594	937,285
Total net incurred losses and loss expenses	7,465,001	4,911,488	4,696,427
Exchange rate effects	(375,749)	309,768	394,121
Net loss reserves acquired	□	□	199,164
Less net losses and loss expenses paid in respect of losses occurring in:			
Current year	602,153	1,081,547	360,767
Prior years	2,007,613	1,984,790	2,521,517
Total net paid losses	2,609,766	3,066,337	2,882,284
Net unpaid losses and loss expenses at end of year	17,355,024	12,875,538	10,720,619
Unpaid losses and loss expenses recoverable	6,412,648	6,962,131	6,042,505
Unpaid losses and loss expenses at end of year	\$ 23,767,672	\$ 19,837,669	\$ 16,763,124

The Company's net unpaid losses and losses expense reserves broken down by operating segment at December 31, 2005 and 2004 was as follows:

<i>(U.S. dollars in millions)</i>	December 31, 2005	December 31, 2004
Insurance	\$ 9,860	\$ 6,975
Reinsurance	7,212	5,695
Financial products and services	283	205
Net unpaid loss and loss expense reserves	\$ 17,355	\$ 12,875

Current year net losses incurred

Current year net losses incurred in 2005 increased from 2004 due primarily to the impact of Hurricanes Katrina, Rita and Wilma being greater than that of the 2004 Atlantic hurricanes. There was a relatively low level of catastrophic events affecting the Company in 2003.

Collectively, Hurricanes Katrina, Rita, Wilma and other smaller natural catastrophes in the third and fourth quarters of 2005 have had a substantial impact on the results of the Company for the year ended December 31, 2005. The Company has estimated losses incurred, net of reinsurance recoveries, of \$1.27 billion, \$357.9 million, \$247.1 and \$96.0 million related to Hurricane Katrina, Rita, Wilma, and the combined impact of the other catastrophes, respectively, based on preliminary reports and estimates to loss and damage.

The 2004 Atlantic hurricane season resulted in four insured hurricane losses aggregating to what was at the time the largest seasonal loss in history and had a substantial impact on the results of the Company for that year. For the four hurricane losses, the Company incurred in 2004 net losses of \$516.6 million, net of reinsurance recoverables.

Prior year net losses incurred

The following tables present the development of the Company's gross and net, losses and loss expense reserves for its general and financial operations. The tables also show the estimated reserves at the beginning of each fiscal year and the favorable or adverse development (prior year development) of those reserves during such fiscal year.

Gross*(U.S. dollars in millions)*

	2005	2004	2003
Unpaid losses and loss expense reserves at the beginning of the year	\$ 19,838	\$ 16,763	\$ 13,333
Net adverse development of those reserves during the year	371	1,636	1,871
Unpaid losses and loss expense reserves re-estimated one year later	\$ 20,209	\$ 18,399	\$ 15,204

Net*(U.S. dollars in millions)*

	2005	2004	2003
Unpaid losses and loss expense reserves at the beginning of the year	\$ 12,875	\$ 10,721	\$ 8,313
Net adverse development of those reserves during the year	1,114	268	937
Unpaid losses and loss expense reserves re-estimated one year later	\$ 13,989	\$ 10,989	\$ 9,250

As different reinsurance programs cover different underwriting years, contracts and lines of business, net and gross loss experience do not develop proportionately. In particular, gross adverse development in 2004 related primarily to the acquired Winterthur International insurance operations (the "Winterthur Business"), which was reinsured through the post closing protection referred to below.

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

(U.S. dollars in millions)

	2005	2004	2003
Insurance Segment	\$ 1,020	\$ 292	\$ 153
Reinsurance Segment	94	(24)	799
Financial Products and Services Segment	□	□	(15)
Total	\$ 1,114	\$ 268	\$ 937

Prior years net adverse development in 2005 was impacted by the unfavorable conclusion of the independent actuarial process with Winterthur Swiss Insurance Company, as \$834.2 million of reinsurance recoverables related to post closing protection on the acquired Winterthur Business were rendered uncollectible. In addition the Company incurred higher than expected development relating to U.S. casualty and professional reinsurance businesses of \$267.0 million and excess professional liability insurance lines of business of \$259.5 million. Partially offsetting this adverse development were releases of \$211.6 million in reinsurance and insurance property lines of business globally and to a lesser degree casualty insurance business written on the Company's European Global Risk platform.

Prior years net adverse development in 2004, related primarily to increases in reported insurance case reserves for excess professional liability, excess casualty and specialty lines.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 9 to the Consolidated Financial Statements for further information regarding the developments in prior year loss reserve estimates for each of the years indicated within each of the Company's operating segments.

Net loss reserves acquired

There were no net loss reserves acquired in 2005 or 2004.

Net loss reserves acquired in 2003 of \$199.2 million included \$85.2 million related to the Company's Lloyd's operation in connection with the closure of the Lloyd's 2000 underwriting year where reserves and cash were transferred to the Company's Lloyd's Syndicates. The Company did not provide 100% of the Syndicate capacity for the 2000 underwriting year. In addition, \$114.0 million related to the settlement of the purchase price in December 2003 for the acquisition of certain Winterthur International insurance operations. In connection with the settlement, the Company updated the fair value of the net assets acquired as of this date and reduced the estimated amount of unpaid losses recoverable from the Winterthur Swiss Insurance Company ("WSIC") under the Sale and Purchase Agreement, as amended, between XL Insurance (Bermuda) Ltd and WSIC. For further information see Item 8, Note 5(b) to the Consolidated Financial Statements.

Exchange rate effects

Exchange rate effects on net loss reserves in each of the three years ended December 31, 2005 related to the global operations of the Company where several operations have a functional currency that is not the U.S. dollar. The increase in the value of the U.S. dollar in 2005 and the reduction in the value of the U.S. dollar during the two preceding years mainly compared to the Swiss franc, U.K. sterling and the Euro has given rise to translation and revaluation exchange movements of \$(375.7) million, \$309.8 million and \$394.1 million in 2005, 2004 and 2003, respectively.

Net paid losses

Total net paid losses were \$2.6 billion in 2005 and \$3.1 billion and \$2.9 billion in 2004 and 2003, respectively. For 2005, the decrease in net paid losses over 2004 relates primarily to the recovery from Winterthur Swiss Insurance Company upon conclusion of the independent actuarial process, partially offset by payments for catastrophes in both 2004 and 2005. The increase in net paid losses in 2004 relates to both the increase in business over the last several years and the payments associated with the 2004 Atlantic hurricane losses. See further information under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Other loss related information

The Company's net incurred losses and loss expenses include actual and estimates of potential non-recoveries from reinsurers. As at December 31, 2005 and 2004, the reserve for potential non-recoveries from reinsurers was \$234.3 million and \$280.7 million, respectively.

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, and discounts such losses using an interest rate of 5% (2004: 5%). The Company decreased the interest rate in 2003 from 7% to 5%. The effect of the decrease in the interest rate resulted in an increase in loss reserves of approximately \$35.0 million in 2003. The tabular reserving methodology results in applying uniform and consistent criteria for establishing expected future indemnity and medical payments (including an explicit factor for inflation) and the use of mortality tables to determine expected payment periods. Tabular unpaid losses and loss expenses, net of reinsurance, at December 31, 2005 and 2004 were \$716.7 million and \$578.6 million, respectively. The related discounted unpaid losses and loss expenses were \$322.2 million and \$290.0 million as of December 31, 2005 and 2004, respectively.

Investments

Investment structure and strategy

The Company's investment operations are managed centrally by the Company's investment department, which also provides certain investment advice and support for the rest of the Company's operations. The Finance Committee

of the Board of Directors approves the Company's overall investment policy and guidelines and reviews the implementation of the investment strategy on a regular basis.

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and build book value for the Company over the longer term. The strategy strives to maximize investment returns while taking into account market and credit risk. Market risk is due to interest rate variability and exposure to foreign denominated currencies, which the Company seeks to manage through asset/liability management, and due to the allocation to risk assets, including global equity securities, which the Company seeks to manage through diversification. Credit risk arises from investments in fixed income securities and is managed with aggregate and portfolio limits.

The Company's overall investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance. At December 31, 2005 and 2004, total investments, cash and cash equivalents and accrued investment income, less net payable for investments purchased, was \$41.6 billion and \$32.4 billion, respectively.

Functionally, the Company's investment portfolio is divided into four principal components. The largest component is the general account asset/liability portfolio supporting property and casualty and financial guaranty liabilities, which was approximately \$23.7 billion and \$18.4 billion at December 31, 2005 and 2004, respectively. The key focus for this component is asset and liability management and it is used to provide liquidity to settle claims arising from the Company's general and financial operations. The asset/liability portfolio is made up entirely of investment grade fixed income securities.

The second component of the investment portfolio is the structured and spread product portfolio, which was approximately \$13.7 billion and \$9.7 billion at December 31, 2005 and 2004, respectively. This portfolio consists of highly structured actively managed investment portfolios that support specific insurance and reinsurance transactions, *e.g.*, deposit liability and future policy benefit reserves. Many of these transactions have underlying liabilities that pay out over many years. As a result, asset and liability management is also a key focus for this portfolio.

The third component of the investment portfolio is the risk asset portfolio, which was approximately \$3.8 billion and \$3.9 billion at December 31, 2005 and 2004, respectively. The Company utilizes a risk budgeting framework for the dynamic risk and asset allocation of the risk asset portfolio. The risk asset portfolio is that portion of the Company's surplus that is invested in risk assets to generate growth in the Company's book value over the longer term with the efficient utilization of risk. The fundamental premise of the risk budgeting methodology for the risk asset portfolio is to maximize expected returns for a given level of risk. The risk asset portfolio currently includes four core diversified total return strategy portfolios incorporating: (i) alternative investment strategies; (ii) high yield fixed income; (iii) public equities; and (iv) private investments, which include private equity and mezzanine funds and non-rated tranches of collateralized debt obligations.

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

The alternative investment portfolio, part of the risk asset portfolio, is a highly diversified portfolio of investments in limited partnerships and similar investment vehicles, with each fund generally pursuing absolute return investment mandates. These are typically investing in one or more of the traditional asset classes including equities, fixed income, credit, currency and commodity markets, and similar investment vehicles. For the majority of the portfolio, the Company owns minority investment interests that are accounted for under the equity method and are

included in the Consolidated Balance Sheet under "Investments in affiliates." The investment objective of the alternative investment portfolio is to attain a high risk-adjusted total return while maintaining a moderate to low level of sensitivity to the movements in traditional asset classes and realizing a low volatility. This portfolio was \$1.7 billion and \$1.7 billion at December 31, 2005 and 2004.

The fourth component of the Company's total investment portfolio, valued at \$0.4 billion at December 31, 2005 and 2004, is related to insurance and financial affiliates and investments in investment management companies. At December 31, 2005, the Company owned minority stakes in eight independent investment management companies. These ownership stakes are part of the Company's asset management strategy, pursuant to which the Company seeks to develop relationships with specialty investment management organizations, generally acquiring an equity interest in the business. In these investments, the Company seeks to achieve strong returns on capital while accessing the investment expertise of professionals to help manage portions of the Company's investment assets. In addition, the Company is active in the relationships with these managers, seeking to benefit from the intellectual capital in ways that will enhance the Company's overall financial performance and achieve broader strategic goals.

Where the Company maintains significant influence over the decisions of the investment management organization, through board representation or through certain voting and/or consent rights, the Company's proportionate share of the income or loss from these companies is reported as net income from operating affiliates. The Company's existing managers manage or sponsor a broad range of investment products, providing institutional and high net worth investors access to a wide array of asset classes and investment strategies. It is a strategic objective of the Company to continue to expand the diversification of investment products offered by its affiliates by assisting existing affiliates in launching new products and new lines of business as well as by making additional ownership investments in other specialty asset managers. See Item 8, Note 6 to the Consolidated Financial Statements.

Implementation of investment strategy

Although the Company's investment department is responsible for implementation of the investment strategy, the day-to-day management of the investment portfolio is outsourced to investment management service providers. External investment managers are selected and monitored using a disciplined due diligence process. Each investment manager may manage one or more portfolios and is governed by a detailed set of investment guidelines, including overall objectives, risk parameters, and diversification requirements that fall within the overall guidelines discussed above. Compliance with investment guidelines is monitored on a regular basis by the investment department.

Investment performance

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

Credit ratings, duration and maturity profile

It is the Company's policy to operate the aggregate fixed income portfolio with a minimum weighted average credit rating of "Aa3/AA-." The aggregate credit rating is determined based on the market value weighted average credit rating using a linear credit rating scale similar to that used by Moody's. The highest credit rated fixed income securities are held within the asset/liability and structured product portfolios. Sub-investment grade (high yield) fixed income securities are held within the risk asset portfolio. The weighted average credit rating of the fixed income portfolio was "Aa2/AA" at December 31, 2005 and 2004.

The Company did not have an aggregate investment in a single entity, other than the U.S. Government, in excess of 10% of shareholders' equity at December 31, 2005 or 2004.

The aggregate duration of the fixed income portfolio is managed relative to liabilities. Duration measures bond price volatility and is an indicator of the sensitivity of the price of a bond (or a portfolio of bonds) to changes in interest rates, assuming a parallel change in the yield curve reflecting the percentage change in price for a 100 basis point change in yield. Management believes that the duration of the fixed income portfolio is the best single measure of interest rate risk and the table below summarizes the weighted average duration in years of the main components of the fixed income portfolio at December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Asset/Liability portfolio:		
General Account	3.2	3.3
Structured and Spread Products	5.1	6.5
Total Fixed Income portfolio	3.9	4.4

The maturity profile of the fixed income portfolio is a function of the maturity profile of liabilities and, to a lesser extent, the maturity profile of common fixed income benchmarks. For further information on the maturity profile of the fixed income portfolio see Item 8, Note 6 to the Consolidated Financial Statements.

Ratings

The Company's ability to underwrite business is dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent agencies.

In March of 2006, Fitch upgraded the long-term debt ratings for XL Capital Ltd and XL Capital Finance (Europe) plc to [A] from [A-]. The outlooks remain stable.

In the fourth quarter of 2005, Standard & Poor's, lowered the Company's core property and casualty operating companies' financial strength ratings to [A+] from [AA-] and affirmed them with a stable outlook. During this period, Moody's Investors Service, Inc. also lowered the insurance financial strength ratings of the Company's leading insurance operating subsidiaries to [Aa3] from [Aa2] and confirmed the insurance financial strength ratings of its leading reinsurance operating subsidiaries at [Aa3]. In October 2005, Fitch Ratings Inc. lowered the insurance financial strength ratings of the Company's lead insurance and reinsurance operating subsidiaries to [AA-] from [AA]. A.M. Best Company, Inc. affirmed the Company's financial strength rating of [A+] and its operating subsidiaries' issuer credit ratings of [aa-] in December 2005. The Company subsequently raised \$3.2 billion through the issuance of ordinary shares and equity security units.

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The following are the financial strength and claims paying ratings from internationally recognized rating agencies in relation to the Company's principal insurance and reinsurance subsidiaries and pools as at December 31, 2005:

Rating agency	Agency's description of rating	Rating	Agency's rating definition	Ranking of Rating
Standard & Poor's	<p>“A current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms.”</p>	<p>A+ (Outlook Stable)</p>	<p>“Strong” financial security characteristics.</p>	<p>The “A” grouping is the third highest out of nine main ratings. Main ratings from AA to CCC are subdivided into three subcategories: “+” indicating the high end of the main rating; no modifier, indicating the mid range of the main rating; and “-” indicating the lower end of the main rating.</p>
Fitch	<p>“An assessment of the financial strength of an insurance organization, and its capacity to meet senior obligations to policyholders and contract holders on a timely basis.”</p>	<p>AA- (Outlook Stable)</p>	<p>“Very strong” capacity to meet policyholder and contract obligations.</p>	<p>The “AA” rating is the second highest out of twelve ratings categories. AA insurers are viewed as possessing very strong capacity to meet policyholder and contract obligations. “+” or “-” may be appended to a rating to indicate the relative position of a credit within the rating category.</p>
A.M. Best	<p>“An opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders.”</p>	<p>A+ (Outlook Stable)</p>	<p>“Superior” ability to meet its obligations to policyholders.</p>	<p>The “A+” grouping is the second highest ratings category out of fifteen. It is assigned to companies that have, in A.M. Best's opinion, a superior ability to meet their ongoing obligations to policyholders.</p>
Moody's	<p>An opinion of “the ability of</p>	<p>Aa3</p>	<p>“Excellent”</p>	<p>The “Aa” grouping is the</p>

insurance companies to
repay
punctually senior
policyholder
claims and obligations.□

(Outlook financial security.
Stable)

second highest out of nine
rating categories. Each
rating
category is subdivided into
three subcategories. Moody's
appends numerical modifiers
1,
2, and 3 to each generic
rating
classification from Aa
through
Caa. Numeric modifiers are
used to refer to the ranking
within a group □ with 1 being
the highest and 3 being the
lowest.

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The following were the current financial strength and claims paying ratings from internationally recognized rating agencies in relation to the Company's principal insurance and reinsurance subsidiaries and pools as at December 31, 2004:

Rating agency	Agency's description of rating	Rating	Agency's rating definition	Ranking of Rating
Standard & Poor's	<p>□A current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms.□</p>	<p>AA- (Stable)</p>	<p>□Very strong□ financial security characteristics.</p>	<p>This is the second highest out of nine main ratings. Main ratings from AA to CCC are subdivided into three subcategories: □+□, indicating the high end of the main rating; no modifier, indicating the mid range of the main rating; and □-□, indicating the lower end of the main rating.</p>
Fitch	<p>□An assessment of the financial strength of an insurance organization, and its capacity to meet senior obligations to policyholders and contract holders on a timely basis.□</p>	<p>AA (Stable)</p>	<p>□Very strong□ capacity to meet policyholder and contract obligations.</p>	<p>The □AA□ rating is the second highest of twelve ratings categories. AA insurers are viewed as possessing very strong capacity to meet policyholder and contract obligations. □+□ and □-□ may be appended to a rating to indicate the relative positive of a credit within the rating category.</p>
A.M. Best	<p>□An opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders.□</p>	<p>A+ (Outlook Negative)</p>	<p>□Superior□ ability to meet its obligations to policyholders</p>	<p>This is the second highest out of fifteen ratings.</p>
Moody's	<p>An opinion of □the ability of</p>	<p>Aa2 (except</p>	<p>□Excellent□</p>	<p>The □Aa□ grouping is the</p>

insurance companies to
repay
punctually senior
policyholder
claims and obligations.□

members of
the XL
America Pool,
XL Re Ltd, and
XL Life Insurance
and Annuity
Company, which
are rated Aa3)
(Outlook
Stable)

financial
security.

second highest out of
nine
rating categories. Each
rating
category is subdivided
into
three subcategories.
Moody's
appends numerical
modifiers 1,
2, and 3 to each generic
rating
classification from Aa
through
Caa. Numeric modifiers
are
used to refer to the
ranking
within a group □ with 1
being
the highest and 3 being
the
lowest.

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The following are the financial strength ratings from internationally recognized rating agencies currently and as of December 31, 2004 and 2005 in relation to the Company's principal financial guaranty insurance and reinsurance subsidiaries:

Rating agency	Agency's description of rating	Rating	Agency's rating definition	Ranking of Rating
Standard & Poor's	An opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms.	AAA	Extremely strong financial security characteristics.	This is the highest out of nine main ratings groupings.
Moody's	An opinion of the ability of insurance companies to repay punctually senior policyholder claims and obligation.	Aaa	Exceptional financial security	This is the highest out of nine main ratings categories.
Fitch	An assessment of the financial strength of an insurance organization, and its capacity to meet senior obligations to policyholders and contract holders on a timely basis.	AAA	Exceptionally strong capacity to meet policyholder and contract obligations.	This is the highest out of twelve main ratings categories.

In addition, XL Capital Ltd currently has the following long term debt ratings: "a-" (stable) from A.M. Best, "A-" (stable) from Standard and Poor's, "A3" (stable) from Moody's and "A-" (stable) from Fitch.

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

Tax Matters

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 23 to the Consolidated Financial Statements.

Regulation

The Company's operations are subject to regulation and supervision in each of the jurisdictions where they are domiciled and licensed to conduct business. Generally, regulatory authorities can have broad supervisory and

administrative powers over such matters as licenses, fitness of management, standards of solvency, material transactions between affiliates, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of financial statements, reserves for unpaid losses and loss adjustment expenses, reinsurance, minimum capital and surplus requirements and/or risk based capital standards, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. In general, such regulation is for the protection of policyholders rather than shareholders. The Company believes that it is in compliance with all applicable laws and regulations pertaining to its business that would have a material effect on its financial position in the event of non-compliance.

Bermuda Operations

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

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

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

United States

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

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

The Company's U.S. insurance subsidiaries are required to file detailed annual and, in most states, quarterly reports with state insurance regulators in each of the states in which they are licensed. Such annual and quarterly reports are required to be prepared on a calendar year basis. In addition, the U.S. insurance subsidiaries' operations and accounts are subject to financial condition and market conduct examination at regular intervals by state regulators. The respective reports filed in accordance with applicable insurance regulations with respect to the most recent periodic examinations of the U.S. insurance subsidiaries contained no material adverse findings.

Statutory surplus is an important measure utilized by the regulators and rating agencies to assess the Company's U.S. insurance subsidiaries' ability to support business operations and provide dividend capacity. The Company's U.S. insurance subsidiaries are subject to various state statutory and regulatory restrictions that limit the amount of dividends that may be paid from earned surplus without prior approval from regulatory authorities. These restrictions differ by state, but are generally based on a calculation of the lesser of 10% of statutory surplus or 100% of net investment income.

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

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

European Union

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

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

Subsidiaries in Ireland, Hungary and France are regulated in those jurisdictions. The Company's network of offices in the European Union consists mainly of branches of U.K. and Irish companies that are principally regulated under European Directives from their home states, the U.K. and Ireland rather than by each individual jurisdiction.

International Operations

A substantial portion of the Company's general insurance business and a majority of its life insurance business is carried on in foreign countries. The degree of regulation in foreign jurisdictions can vary. Generally, the Company's subsidiaries must satisfy local regulatory requirements. Licenses issued by foreign authorities to subsidiaries of the Company are subject to modification or revocation for cause by such authorities. The Company's subsidiaries could be prevented, for cause, from conducting business in certain of the jurisdictions where they currently operate. While each country imposes licensing, solvency, auditing and financial reporting requirements, the type and extent of the requirements differ substantially. Key areas where countries may differ include: (i) the type of financial reports to be

filed; (ii) a requirement to use local intermediaries; (iii) the amount of reinsurance permissible; (iv) the scope of any regulation of policy forms and rates; and (v) the type and frequency of regulatory examinations.

In addition to these requirements, the Company's foreign operations are also regulated in various jurisdictions with respect to currency, amount and type of security deposits, amount and type of reserves, amount and type of local investment and limitations on the share of profits to be returned to policyholders on participating policies. Certain countries have established reinsurance institutions, wholly or partially owned by the state, to which admitted insurers are obligated to cede a portion of their business on terms which do not always allow foreign insurers full compensation. For further information see Item 8, Note 24 to the Consolidated Financial Statements.

Employees

At December 31, 2005, the Company employed approximately 3,600 employees. At that date, 385 of the Company's employees were represented by workers' councils and 423 of the Company's employees were subject to collective bargaining agreements. The Company believes that it has a good relationship with its employees.

Available Information

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

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

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

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

The Company intends to post on its website at <http://www.xlcapital.com> any amendment to, or waiver from, a provision of its Code of Business Conduct & Ethics that applies to its Chief Executive Officer, Chief Financial Officer and Controller and that relates to any element of the code of ethics definition pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended.

ITEM 1A. RISK FACTORS

Any of the following risk factors could have a significant or material adverse effect on our business, financial condition, results of operations and/or liquidity, in addition to the other information contained in this report. Additional risks not presently known to us or that we currently deem immaterial may also impair our business, financial condition and results of operations. In this Item 1A, "XL Capital", "XL Group", "we", "our", "ours" and "us" refer to XL Capital Ltd and its subsidiaries unless the context otherwise requires.

Risks Related to Our Company

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

In the fourth quarter of 2005, Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") lowered XL Capital's core property and casualty operating companies' financial strength ratings to "A+" from "AA-" and affirmed them with a stable outlook. During this period, Moody's Investors Service, Inc. ("Moody's") also lowered the insurance financial strength ratings of XL Capital's leading insurance operating subsidiaries to "Aa3" from "Aa2" and confirmed the insurance financial strength ratings of XL Capital's leading reinsurance operating subsidiaries at "Aa3". In October 2005, Fitch Ratings Inc. ("Fitch") lowered the insurance financial strength ratings of XL Capital's lead insurance and reinsurance operating subsidiaries to "AA-" from "AA." A.M. Best Company, Inc. ("A.M. Best") affirmed XL Capital's financial strength rating of "A+" and XL Capital's operating subsidiaries' issuer credit ratings of "aa-" in December 2005. As our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by these independent rating agencies, a further downgrade by any of these institutions could cause our competitive position in the insurance and reinsurance industry to suffer and make it more difficult for us to market our products. A downgrade could also result in a substantial loss of business for us as ceding companies and brokers that place such business may move to other insurers and reinsurers with higher ratings.

A downgrade of the A.M. Best financial strength rating of XL Capital Ltd, XL Insurance (Bermuda) Ltd or XL Re Ltd below "A-", which is two notches below our current A.M. Best rating of "A+", would constitute an event of default under our letter of credit and revolving credit facilities. A similar downgrade by A.M. Best or S&P would trigger cancellation provisions in the majority of our assumed reinsurance contracts. See "Risks Related to Our Company" A decline in our ratings may allow many of our clients to terminate their contracts with us, below. Either of these events could reduce our financial flexibility and materially adversely affect our business, financial condition and results of operations. For further discussion, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations".

S&P, Moody's and Fitch have assessed "triple-A" (outlook stable) financial strength ratings to our financial guaranty companies, XL Capital Assurance Inc. ("XLCA") and XL Financial Assurance Ltd. ("XLFA"). A downgrade, rating watch or outlook change of the financial strength ratings of XLCA or XLFA by one or more rating agencies would have an adverse effect on the competitive position of XLCA and XLFA and reduce their future business opportunities. Such a downgrade would reduce the value of the reinsurance offered by XLFA, as financial guaranty primary insurers usually must obtain triple-A-rated reinsurance to qualify for a 100% reinsurance credit on the rating agencies' capital adequacy models. Also, certain of XLFA's reinsurance agreements contain provisions that allow the ceding primary insurer to terminate the agreement in the event of a downgrade in XLFA's credit ratings or other event that would result in the reinsurance credit provided by XLFA to the ceding primary insurer being diminished. To address rating agency requirements regarding the differential between the triple-A ratings of our financial guaranty companies and their affiliated companies in the XL Group, we are currently exploring a number of strategies that would provide greater independence and stability to XLCA's and XLFA's ratings. Examples of actions identified by the rating agencies are, among other things, the inclusion of additional independent directors to the boards of directors of our financial guaranty companies; adding some level of outside high-quality ownership with voting and/or veto rights; and securing a resolution from each of the boards of directors of our financial guaranty companies that clarifies

our expectations regarding cash payments from the financial guaranty companies. S&P has stated that one or more of these actions will need to be taken by mid-year 2006.

A decline in our ratings may allow many of our clients to terminate their contracts with us.

The majority of our assumed reinsurance contracts contain provisions that would allow our clients to cancel the contract in the event of a downgrade in our ratings below specified levels by one or more rating agencies. Based on premium value, approximately 70% of our reinsurance contracts that inceptioned at January 1, 2005 contained provisions allowing clients additional rights upon a decline in our ratings.

Typically, the cancellation provisions in our assumed reinsurance contracts would be triggered if S&P or A.M. Best were to downgrade our financial strength ratings below [A-], which is equivalent to more than two levels below our current S&P rating of [A+] and more than two levels below our current A.M. Best rating of [A+]. Whether a client would exercise its cancellation rights after such a downgrade would likely depend, among other things, on the reasons for the downgrade, the extent of the downgrade, the prevailing market conditions, the degree of unexpired coverage, and the pricing and availability of replacement reinsurance coverage. In the event of such a downgrade, we cannot predict whether or how many of our clients would actually exercise such cancellation rights or the extent to which any such cancellations would have a material adverse effect on our financial condition or future prospects.

Losses related to Hurricanes Katrina, Rita and Wilma and other natural catastrophes have adversely affected our fiscal year 2005 results and uncertainty regarding estimated losses may further impact our financial condition, results of operations and/or liquidity.

Based on current loss reports and estimates at December 31, 2005, we had pre-tax net losses arising from Hurricanes Katrina, Rita and Wilma and the combined impact of other previously announced natural catastrophes in 2005 of approximately \$1.27 billion, \$357.9 million, \$247.1 million and \$96.0 million, respectively. After taking into account net reinstatement premiums and tax effects, we had net losses due to these catastrophes of approximately \$1.87 billion. However, calculating such estimates involves the exercise of considerable judgment and they are accordingly subject to revision. These losses have materially adversely affected our fiscal year 2005 results.

Our loss estimates are based upon a review of contracts that we believe are exposed to these catastrophes, loss reports received from brokers and cedents, industry loss models and management's best judgment, including as to the availability and collectibility of reinsurance. We expect that the loss adjustment processes for Hurricanes Katrina and Rita will be protracted due to the unprecedented complexity and scale of these events.

Actual losses may vary materially from our estimates. Such variances may be caused by a number of factors, including receipt of additional information from insureds or brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. In addition, such loss estimates include a high level of uncertainty related to, among other things, complex coverage issues, claims data received to date and potential legal developments that may result in ultimate losses not being known for a considerable period of time as well as the availability and collectibility of reinsurance. Therefore, these losses may ultimately be materially greater than currently estimated. If our actual losses exceed our estimates, our financial condition and results of operations could be further materially adversely affected.

We have exhausted certain of our reinsurance and retrocessional coverage with respect to losses related to Hurricanes Katrina, Rita and Wilma leaving us exposed to further losses.

Based on our current estimates of losses related to Hurricanes Katrina, Rita and, to a lesser degree, Wilma, we believe that we have exhausted portions of our reinsurance and retrocessional coverage with respect to such losses, meaning that, in certain cases, we will have no further reinsurance or retrocessional coverage available should our losses related to Hurricanes Katrina, Rita and Wilma prove to be greater than current estimates. If losses related to Hurricanes Katrina, Rita and Wilma prove to be greater than current estimates, to the extent that such adverse development affects lines of business with respect to which we have exhausted our reinsurance or retrocessional coverage, such adverse development could have a further material adverse effect on our financial condition and results of opera-

tions. We cannot assure you that reinsurance or retrocessional coverage with respect to the lines of business affected by the Hurricanes Katrina, Rita and Wilma will be available to us on acceptable terms, or at all, in the future. Elimination of all or portions of our reinsurance or retrocessional coverage could subject us to increased, and possibly material, exposure or could cause us to underwrite less business.

We may be unable to make full recovery of the reinsurance recoverables related to the Winterthur Business, either from third parties or from Winterthur Swiss Insurance Company (WSIC).

Under the terms of the Sale and Purchase Agreement, as amended, between XL Insurance (Bermuda) Ltd and WSIC (the "SPA"), WSIC provides us with protection with respect to third party reinsurance receivables and recoverables related to our acquisition of certain Winterthur International insurance operations (the "Winterthur Business"), which were approximately \$1.6 billion, in the aggregate, as of December 31, 2005. There are two levels of protection from WSIC for these balances:

1. At the time of the Winterthur International acquisition, the Seller provided to the Company a liquidity facility. At the time of the payment of the net reserve seasoned amount on December 12, 2005, the Company exercised its right to repay up to the balances outstanding on this facility by assignment to WSIC of an equal amount of receivables relating to reinsurance recoverables selected by the Company. During December 2005, the Company assigned \$265.4 million of receivables to WSIC under this arrangement, although WSIC has disputed the assignment of certain of these receivables
2. Under two retrocession agreements the Company has reinsurance protection on the reinsurance recoverables with respect to the SNRA determined as of June 30, 2004 to the extent that the Company does not receive payment of such amounts from applicable reinsurers with one agreement providing a limit of \$1.3 billion for the insurance written in the period to June 30, 2001 and the other agreement providing a limit of \$1.3 billion for the insurance written in the period to December 31, 2000.

Certain reinsurers responsible for some portions of the reinsurance of the Winterthur Business have raised issues as to whether amounts claimed are due and discussions are currently ongoing to achieve a resolution.

We may record a loss in future periods if any or some of the following occur and any such loss could have a material adverse effect on our financial condition and results of operations:

- there is deterioration of the net reserves and premium balances relating to the Winterthur Business from what was reported in our Consolidated Financial Statements; and/or
- we are unable to make full recovery of the reinsurance recoverables related to the Winterthur Business, either from third parties or from WSIC under the additional protections described above.

Our financial condition could be adversely affected by the occurrence of disasters.

We have substantial exposure to losses resulting from natural and man-made disasters and other catastrophic events. Catastrophes can be caused by various events, including hurricanes, earthquakes, floods, hailstorms, explosions, severe winter weather, fires, war, acts of terrorism, political instability and other natural or man-made disasters. The incidence and severity of catastrophes are inherently unpredictable and our losses from catastrophes could be substantial.

The occurrence of claims from catastrophic events is likely to result in substantial volatility in our financial condition and results of operations for the fiscal quarter or year in which a catastrophic event occurs, as well as subsequent fiscal periods, and could have a material adverse effect on our financial condition and results of operations and our ability to write new business. This risk is exacerbated due to accounting principles and rules that do not permit reinsurers to reserve for such catastrophic events until they occur. We expect that increases in the values and concentrations of insured property will increase the severity of catastrophic events in the future. Although we attempt to manage our exposure to catastrophic events, a single catastrophic event could affect multiple geographic zones and lines of business and the frequency or severity of catastrophic events could exceed our estimates, in each case potentially

having a material adverse effect on our financial condition and results of operations. In addition, while we may, depending on market conditions, purchase catastrophe reinsurance and retrocessional protection, the occurrence of one or more major catastrophes in any given period could result in losses that exceed such reinsurance and retrocessional protection and have a material adverse effect on our financial condition and results of operations and result in substantial liquidation of investments and outflows of cash as losses are paid.

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

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

The failure of our initiative to reduce our net catastrophe exposed risks could have a material adverse effect on our financial condition, results of operations and/or liquidity.

Certain of our insurance accounts have the potential for significant volatility under worsening catastrophe event scenarios. In connection with our initiative to reduce our net catastrophe exposed risks, we intend to reduce exposure from such accounts, reduce catastrophe sublimits and eliminate insurance accounts that no longer meet our increased pricing needs. In addition, we plan to reduce our reinsurance catastrophe exposure within the property risk portfolio and restructure the way in which our marine excess of loss programs are written. If we are unable to carry out our initiative to reduce our net catastrophe exposed risks, or do so on a timely basis, we may not be able to meet rating agencies' additional capital requirements and our financial condition and results of operations and/or liquidity could be materially adversely affected.

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

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

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

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

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

We believe that our modeling, underwriting and information technology and application systems are critical to our business. Moreover, our information technology and application systems have been an important part of our underwriting process and our ability to compete successfully. We have also licensed certain systems and data from third parties. We cannot be certain that we will have access to these, or comparable, service providers, or that our information technology or application systems will continue to operate as intended. A major defect or failure in our internal controls or information technology and application systems could result in management distraction, harm to our reputation or increased expense. We believe appropriate controls and mitigation procedures are in place to prevent significant risk of defect in our internal controls, information technology and application systems, but internal controls provide only reasonable, not absolute, assurance as to the absence of errors or irregularities and any ineffectiveness of such controls and procedures could have a material adverse effect on our business.

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

As industry practices and legal, judicial, social and other environmental conditions change, unexpected issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued the insurance or reinsurance contracts that are affected by the changes. For example, our actual losses in connection with the 2005 natural catastrophes may vary materially from our current estimate based on a number of factors, including receipt of additional information from insureds or brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. As a result, the full extent of liability under an insurance or reinsurance contract may not be known for many years after such contract is issued.

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

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover our losses. To the extent that the funds generated by our ongoing operations are insufficient to fund future operating requirements and cover claim payments, we may need to raise additional funds through financings or curtail our growth and reduce our assets. Any future equity or debt financing may not be available on terms that are favorable to us, if at all. Any future equity financings could be dilutive to our existing shareholders or could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. Our inability to obtain adequate capital could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to purchase reinsurance and, even if we are able to successfully purchase reinsurance, we are subject to the possibility of uncollectability.

We purchase reinsurance for our own account in order to mitigate the volatility that losses impose on our financial condition. Our clients purchase reinsurance from us to cover part of the risk originally written by them. Retrocessional reinsurance involves a reinsurer ceding to another reinsurer, the retrocessionaire, all or part of the reinsurance that the first reinsurer has assumed. Reinsurance, including retrocessional reinsurance, does not legally discharge the ceding company from its liability with respect to its obligations to its insureds or reinsureds. A reinsurer's or retrocessionaire's insolvency, inability or refusal to make timely payments under the terms of its agreements with us, therefore, could have a material adverse effect on us because we remain liable to our insureds and reinsureds. At December 31, 2005, we had approximately \$7.5 billion of reinsurance recoverables, net of reserves for uncollectible recoverables. For further information regarding our reinsurance exposure, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations".

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

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

We market our insurance and reinsurance products worldwide primarily through insurance and reinsurance brokers. Marsh & McLennan Companies and AON Corporation and their respective subsidiaries provided approximately 21% and 17%, respectively, of our gross written premiums from general operations for the year ended December 31, 2005. Loss of all or a substantial portion of the business provided by one or more of these brokers could have a material adverse effect on our business.

Our reliance on brokers subjects us to credit risk.

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

Our investment performance may adversely affect our financial results and ability to conduct business.

Our funds are invested by a number of professional investment advisory management firms under the direction of our management team in accordance with detailed investment guidelines set by us. Although our investment policies stress diversification of risks, conservation of principal and liquidity, our investments are subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. Investment losses could significantly decrease our asset base, thereby adversely affecting our ability to conduct business and pay claims.

We may be adversely affected by interest rate changes.

Our operating results are affected, in part, by the performance of our investment portfolio. Our investment portfolio contains interest rate sensitive instruments, such as fixed income securities, which may be adversely affected by

changes in interest rates. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, funds reinvested will earn less than expected.

Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we take measures to manage the economic risks of investing in a changing interest rate environment, we may not be able to mitigate the interest rate risk of our assets relative to our liabilities. Our mitigation efforts with respect to interest rate risk are primarily focused towards maintaining an investment portfolio with diversified maturities that has a weighted average duration that is approximately equal to the duration of estimated future paid liabilities. However, our estimate of future paid liabilities may be inaccurate and we may be forced to liquidate investments prior to maturity at a loss in order to cover liabilities. In addition, even if the duration of our fixed income portfolio perfectly matched future paid liabilities, a sharp rise in interest rates would cause the market value of our fixed income portfolio to decline and could have a material adverse effect on our book value.

For further information regarding our exposure to interest rate risk and other investment portfolio risks, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk".

Our operating results may be adversely affected by currency fluctuations.

Our functional currency is the U.S. dollar and exchange rate fluctuations relative to the U.S. dollar may materially impact our financial position and results of operations. Many of our non-U.S. subsidiaries maintain both assets and liabilities in local currencies, which exposes us to changes in currency exchange rates to the extent that we need to convert U.S. dollars into such local currencies or vice versa. In addition, locally-required capital levels are invested in home currencies in order to satisfy regulatory requirements and to support local insurance operations regardless of currency fluctuations. Foreign exchange rate risk is reviewed as part of our risk management process. The principal currencies creating foreign exchange risk for us are the British pound sterling, the euro and the Swiss franc.

While we utilize derivative instruments such as futures, options and foreign currency forward contracts to, among other things, manage our foreign currency exposure, it is possible that these instruments will not effectively mitigate all or a substantial portion of our foreign exchange rate risk.

Current legal and regulatory activities relating to insurance brokers and agents, contingent commissions and certain finite-risk insurance products could adversely affect our business, financial condition and results of operations.

Contingent commission arrangements and finite-risk reinsurance have become the focus of investigations by the U.S. Securities and Exchange Commission (the "SEC") and U.S. Attorney's Offices and state Attorneys General. Finite-risk reinsurance has been defined as a form of reinsurance in which, among other things, the time value of money is considered in the product's design and pricing, and there is less risk transfer to the insurer or reinsurer in return for less premium being paid.

In May and June of 2005, we received a subpoena from the SEC and a grand jury subpoena from the U.S. Attorney's Office for the Southern District of New York, respectively, in each case for documents and information relating to certain finite risk and loss mitigation insurance products. We are fully cooperating with, and responding to, these requests.

On August 1, 2005, plaintiffs in a proposed class action multi-district lawsuit (the "MDL") filed a consolidated amended complaint, which named as new defendants in the pending action approximately 30 entities, including XL Capital Ltd and its subsidiaries XL Insurance America, Inc., Greenwich Insurance Company and Indian Harbor Insurance Company. In the MDL, named plaintiffs have asserted various claims, purportedly on behalf of a class of commercial insureds, against approximately 113 insurance companies and insurance brokers through which the named plaintiffs allegedly purchased insurance. The amended complaint alleges that the defendant insurance companies and insurance brokers conspired to manipulate bidding practices for insurance policies in certain insurance lines and failed to disclose certain commission arrangements. The named plaintiffs have asserted statutory claims under the

Sherman Act, various state antitrust laws and the Racketeer Influenced and Corrupt Organizations Act, as well as common law claims alleging breach of fiduciary duty, aiding and abetting a breach of fiduciary duty and unjust enrichment.

From time to time, we have also received and responded to additional requests from state Attorneys General and insurance regulators for information relating to our contingent commission arrangements with brokers and agents, and our insurance and reinsurance practices in connection with certain finite-risk and loss mitigation insurance products. Similarly, our affiliates outside the United States have, from time to time, received and responded to requests from regulators relating to our insurance and reinsurance practices. We are fully cooperating with these requests.

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

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

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

Many of our senior executives working in Bermuda are not Bermudian and our success may depend in part on the continued services of key employees in Bermuda. Under Bermuda law, non-Bermudians (other than spouses of Bermudians and holders of permanent resident certificates) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. A work permit may be granted or renewed by the Bermuda government for a specific period of time, upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian or holder of a permanent resident certificate) is available who meets the minimum standards reasonably required by an employer with respect to a certain position. The government of Bermuda places a six-year term limit on individuals with work permits, subject to certain exemptions for key employees. No assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term.

Because we are a holding company, if our subsidiaries do not make dividend and other payments to us, we may not be able to pay dividends or make payments on our debt securities and other obligations.

As a holding company with no direct operations or significant assets other than the capital stock of our subsidiaries, we rely on investment income, cash dividends and other permitted payments from our subsidiaries to make principal and interest payments on our debt, to pay operating expenses and common and preferred shareholder dividends and to pay other obligations of ours that may arise from time to time. We expect future investment income, dividends and other permitted payments from these subsidiaries to be our principal source of funds to pay such expenses, preferred and common stock dividends and obligations. The payment of dividends to us by our insurance and reinsurance subsidiaries is limited under Bermuda laws and certain insurance statutes of various states in the United States in which our insurance and reinsurance subsidiaries are licensed to transact business.

Our U.S. insurance and reinsurance subsidiaries are subject to state regulatory restrictions that generally require cash dividend to be paid only out of earned statutory surplus. Further, the amount payable without the prior approval of the applicable state insurance department is generally limited to the greater of 10% of policyholders' surplus or statutory capital, or 100% of the subsidiary's prior year statutory net income. In addition, Bermuda insurance laws and regulations (i) require our insurance and reinsurance subsidiaries to maintain certain minimum solvency margins and minimum liquidity ratios, (ii) prohibit dividends that would result in a breach of these requirements, and (iii) limit the amount by which we can reduce surplus without prior approval from the Bermuda Monetary Authority.

In addition, the ability of our insurance and reinsurance subsidiaries to pay dividends could be constrained by our dependence on financial strength ratings from independent rating agencies. Our ratings from these agencies depend to a large extent on the capitalization levels of our insurance and reinsurance subsidiaries. Any such restriction on our insurance and reinsurance subsidiaries' ability to pay dividends to us could have a material adverse effect on our financial condition and results of operations. Our insurance and reinsurance subsidiaries may not always be able to, or may not, pay preferred and common stock dividends to us sufficient to make our debt payments and pay our operating expenses, shareholder dividends or other obligations.

Risks Related to Our Industry

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

The insurance and reinsurance industries have historically been cyclical, characterized by periods of intense price competition due to excess underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. An increase in premium levels is often offset by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Either of these factors could lead to a significant reduction in premium rates, less favorable policy terms and conditions and fewer submissions for our underwriting services. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the insurance and reinsurance industries significantly.

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

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

Unanticipated losses from terrorism and uncertainty surrounding the future of the Terrorism Risk Insurance Act of 2002 could have a material adverse effect on our financial condition and results of operations.

Following the September 11th terrorist attacks, the Terrorism Risk Insurance Act of 2002, as amended by the Terrorism Risk Insurance Extension Act of 2005, ("TRIA") was enacted to ensure the availability of insurance coverage for "certified" acts of terrorism in the U.S and is scheduled to expire on December 31, 2007. Pursuant to TRIA, in the event of a "certified" act of terrorism, the U.S. Government may become liable to pay, above a specified deductible, a portion of up to 90% of our U.S. insurance operations' losses in fiscal years 2005 and 2006 and 85% of such losses in fiscal year 2007. This deductible is based on prior year gross written premiums for certain commercial lines multiplied by a specified percentage, which is 15%, 17.5% and 20% for fiscal years 2005, 2006 and 2007, respectively. Given the incremental increase in the deductible percentage, the amount of our deductible for 2007 could increase substantially, depending upon the amount of certain direct commercial earned premiums written in 2006. Insurance companies are allowed to purchase commercial reinsurance for their deductible amounts and quota share exposure, however to date there has not been a viable market for such reinsurance coverage in terms of capacity, price or coverage terms. Currently, there is uncertainty as to what effect the changes to TRIA will have on the insurance industry.

Our Lloyds & U.S.-based property and casualty insurers are subject to TRIA. Accordingly, TRIA does not apply to our non-U.S. and non-Lloyds insurance business, or our reinsurance operations.

While we believe our risk management programs, together with the coverage provided under the TRIA are sufficient to reasonably limit our net losses relating to potential future terrorist attacks, we can offer no assurance in that regard. It is not possible to eliminate completely our exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, our financial condition and results of operations could be materially adversely affected. In addition, despite the implementation and extension of the TRIA there remains an uncertainty regarding the future of terrorism coverage should the U.S. government not further extend the TRIA after its expiration on December 31, 2007, or pass subsequent terrorism legislation.

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

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

- Providing insurance and reinsurance capacity in markets and to consumers that we target;
- Requiring our participation in industry pools and guaranty associations;
- Expanding the scope of coverage under existing policies, e.g., following large disasters such as Hurricanes Katrina and Rita;
- Regulating the terms of insurance and reinsurance policies; or
- Disproportionately benefiting the companies of one country over those of another.

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

Risks Related to Regulation

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

Our insurance and reinsurance subsidiaries operate in 29 countries around the world as well as in all 50 U.S. states. Our operations in each of these jurisdictions are subject to varying degrees of regulation and supervision. The laws and regulations of the jurisdictions in which our insurance and reinsurance subsidiaries are domiciled require, among other things, that these subsidiaries maintain minimum levels of statutory capital, surplus and liquidity, meet solvency standards, submit to periodic examinations of their financial condition and restrict payments of dividends and reductions of capital. Statutes, regulations and policies that our insurance and reinsurance subsidiaries are subject to may also restrict the ability of these subsidiaries to write insurance and reinsurance policies, make certain investments and distribute funds.

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

We may not be able to comply fully with, or obtain desired exemptions from, revised statutes, regulations and policies that govern the conduct of our business. Failure to comply with, or to obtain desired authorizations and/or exemptions under, any applicable laws could result in restrictions on our ability to do business or undertake activities that are regulated in one or more of the jurisdictions in which we operate and could subject us to fines and other sanc-

tions. In addition, changes in the laws or regulations to which our insurance and reinsurance subsidiaries are subject, or in the interpretations thereof by enforcement or regulatory agencies, could have a material adverse effect on our business.

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

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

- maintain a minimum level of capital and surplus;
- maintain solvency margins and liquidity ratios;
- restrict dividends and distributions;
- obtain prior approval regarding the ownership and transfer of shares;
- maintain a principal office and appoint and maintain a principal representative in Bermuda;
- file an annual statutory financial return; and
- allow for the performance of certain periodic examinations of XL Insurance (Bermuda) Ltd and XL Re Ltd and their respective financial conditions.

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

We do not presently intend for XL Insurance (Bermuda) Ltd and XL Re Ltd to be admitted to do business in the United States, the United Kingdom or any jurisdiction other than Bermuda. However, we cannot assure you that insurance regulators in the United States, the United Kingdom or elsewhere will not review the activities of XL Insurance (Bermuda) Ltd or XL Re Ltd, their respective subsidiaries or their agents and claim that XL Insurance (Bermuda) Ltd or XL Re Ltd is subject to such jurisdiction's licensing requirements. If any such claim is successful and XL Insurance (Bermuda) Ltd or XL Re Ltd must obtain licenses in a jurisdiction other than Bermuda, we may be subject to taxation in such jurisdiction.

In addition, XL Insurance (Bermuda) Ltd and XL Re Ltd are subject to indirect regulatory requirements imposed by jurisdictions that may limit their ability to provide insurance or reinsurance to that jurisdiction's domestic insurers or reinsurers. For example, the ability of XL Insurance (Bermuda) Ltd and XL Re Ltd to write insurance or reinsurance may be subject, in certain cases, to a country's limits on how much reinsurance can be purchased from non-domestic reinsurers or requirements that such non-domestic reinsurers collateralize their payment obligations to domestic ceding companies. If we are unable to collateralize or provide other credit support for these reinsurance clients on commercially reasonable terms, we could be limited in our ability to write business for some of our clients. Proposed legislation and regulations may have the effect of imposing additional requirements upon, or restricting the market for, non-domestic insurers or reinsurers with whom domestic companies place business.

Generally, Bermuda insurance statutes and regulations applicable to XL Insurance (Bermuda) Ltd and XL Re Ltd are less restrictive than those that would be applicable if they were governed by the laws of any state in the United States. If in the future we become subject to any insurance laws of the United States or any state thereof or of any other jurisdiction, we cannot assure you that we would be in compliance with such laws or that complying with such laws would not have a significant and negative effect on our business.

The process of obtaining licenses is very time consuming and costly and XL Insurance (Bermuda) Ltd and XL Re Ltd may not be able to become licensed in jurisdictions other than Bermuda should we choose to do so. The modification of the conduct of our business that would result if we were required or chose to become licensed in certain jurisdictions could significantly and negatively affect our financial condition and results of operations. In addition-

tion, our inability to comply with insurance statutes and regulations could significantly and adversely affect our financial condition and results of operations by limiting our ability to conduct business as well as subjecting us to penalties and fines.

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

Risks Related to Taxation

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

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

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

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

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

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

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

On June 27, 2005 the Organisation for Economic Co-operation and Development ("OECD") issued a discussion draft, "Attribution of Profits to a Permanent Establishment" ("Release of Discussion Draft of Part IV (Insurance)") (the "Draft"), which constitutes the fourth and final part of the report on OECD's project to establish a broad consensus regarding the interpretation and practical application of Article 7 ("Article 7") of the OECD Model Tax Convention on Income and on Capital. Article 7 sets forth international tax principles for attributing profits to a permanent establishment and forms the basis of an extensive network of bilateral income tax treaties between OECD member countries and between many OECD member and non-member countries. Once finalized, the conclusions of Parts I-IV of the report will be implemented through revision of the Commentary on Article 7 and/or Article 7 itself. Section C of the Draft discusses the application of the 1995 OECD Transfer Pricing Guidelines to insurance business conducted between associated enterprises and, if adopted in its current form, might change the manner in which we are taxed and could therefore impact our future after-tax profitability. We cannot predict the effect of any such changes.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

In July 2003, the Company acquired new offices at 70 Gracechurch Street, London, which have become the Company's new London headquarters. The acquisition was made through a purchase, sale and leaseback transaction. The move to the new offices was completed in 2004 and consolidated the Company's London businesses in one location. The Company has recorded a capital lease asset and liability of approximately \$150.0 million related to this transaction.

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

Total rent expense for the years ended December 31, 2005, 2004 and 2003 was approximately \$34.9 million, \$31.2 million and \$42.3 million, respectively. See Item 8, Note 18(d) to the Consolidated Financial Statements for discussion of the Company's lease commitments for real property.

ITEM 3. LEGAL PROCEEDINGS

On June 21, 2004, a consolidated and amended class action complaint (the "Amended Complaint") was served on the Company and certain of its present and former directors and officers as defendants in a putative class action (Malin et al. v. XL Capital Ltd et al.) filed in United States District Court, District of Connecticut (the "Malin Action"). The Malin Action purports to be on behalf of purchasers of the Company's common stock between November 1, 2001 and October 16, 2003, and alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder (the "Securities Laws"). The Amended Complaint alleged that the defendants violated the Securities Laws by, among other things, failing to disclose in various public and shareholder and investor reports and other communications the alleged inadequacy of the Company's loss reserves for its NAC Re subsidiary (now known as XL Reinsurance America, Inc.) and that, as a consequence, the Company's earnings and assets were materially overstated. On August 26, 2005, the Court dismissed the Amended Complaint owing to its failure adequately to allege "loss causation," but provided leave for the plaintiffs to file a further amended complaint. The plaintiffs thereafter filed a second amended complaint (the "Second Amended Complaint"), which is similar to the Amended Complaint in its substantive allegations. On December 31, 2005, the defendants filed a motion to dismiss the Second Amended Complaint. The plaintiffs have opposed the motion. The Company and the defendant present and former officers and directors intend to vigorously defend the claims asserted against them.

On June 17, 2004, William Kronenberg, III, Frank A. Piliero and David M. Rosenberg (together, the "Claimants") commenced an arbitration against the Company before the American Arbitration Association ("AAA") in New York, New York. The Claimants and the Company were parties to a stock purchase agreement dated June 1, 1999, pursuant to which the Company acquired the outstanding capital stock of ECS, Inc. (the "Stock Purchase Agreement"). In their AAA arbitration demand, the Claimants asserted claims of fraud and deceitful conduct, negligent misrepresentation, and breach of contract and a covenant of good faith and fair dealing, all relating to the allegation that the Company failed to make certain contingent payments allegedly due to the Claimants under the Stock Purchase Agreement. Claimants sought \$85 million (the maximum amount payable under the contingent payment provision at issue), plus punitive damages, interest, costs and attorneys' fees. On February 21, 2006, the AAA panel issued a final award in favor of the Company with respect to the major disputes at issue. The AAA panel referred certain remaining accounting issues to additional arbitration proceedings before an independent accounting firm pursuant to rulings of the United States District Court for the Southern District of New York and the United States Court of Appeals for the Second Circuit concerning the scope of the AAA arbitration. The Claimants have not yet taken a position as to the extent of any damages they may still claim in such arbitration in light of the AAA panel's award. If the

Claimants proceed to arbitration before the accounting firm, the Company will continue to vigorously defend the Claimants' claims.

The Company is also subject to litigation and arbitration in the normal course of its business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company's loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to claims litigation, the Company and its subsidiaries are subject to lawsuits in the normal course of business that do not arise from or directly relate to claims on policies of insurance or contracts of reinsurance.

As previously disclosed, in May and June of 2005, the Company received a subpoena from the SEC and a grand jury subpoena from the U.S. Attorney's Office for the Southern District of New York, respectively, in each case for documents and information relating to certain finite-risk and loss mitigation insurance products. The Company is fully cooperating and responding to these requests.

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

On August 1, 2005, plaintiffs in a proposed class action multi-district lawsuit, captioned *In re Insurance Brokerage Antitrust Litigation*, MDL No. 1663, Civil Action No. 04-5184 (FSH) (the "MDL"), filed a consolidated amended complaint (the "Amended Complaint"), which named as new defendants in the pending action approximately 30 entities, including Greenwich Insurance Company, Indian Harbor Insurance Company and XL Capital Ltd. In the MDL, named plaintiffs have asserted various claims, purportedly on behalf of a class of commercial insureds, against approximately 113 insurance companies and insurance brokers through which the named plaintiffs allegedly purchased insurance. The Amended Complaint alleges that the defendant insurance companies and insurance brokers conspired to manipulate bidding practices for insurance policies in certain insurance lines and failed to disclose certain commission arrangements. The named plaintiffs have asserted statutory claims under the Sherman Act, various state antitrust laws and the Racketeer Influenced and Corrupt Organizations Act, as well as common law claims alleging breach of fiduciary duty, aiding and abetting a breach of fiduciary duty and unjust enrichment. Discovery in the MDL continues. Defendants filed motions to dismiss the Amended Complaint in late November 2005. On February 1, 2006, plaintiffs filed a motion seeking leave to further amend their Amended Complaint to, among other things, add additional defendants, including X.L. America, Inc. and XL Insurance America, Inc. That motion was denied without prejudice. On or about February 13, 2006, plaintiffs filed a motion seeking class certification.

The Company believes that the ultimate outcome of all outstanding litigation and arbitration will not have a material adverse effect on its consolidated financial condition, future operating results and/or liquidity, although an adverse resolution of a number of these items could have a material adverse effect on the Company's results of operations in a particular fiscal quarter or year.

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

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

Executive Officers of the Company

The table below sets forth the names, ages and titles of the persons who were the executive officers of the Company for the year ended December 31, 2005:

Name	Age	Position
Brian M. O'Hara	57	President, Chief Executive Officer and Director
Fiona E. Luck	48	Executive Vice President, Global Head of Corporate Services and Assistant Secretary
Jerry M. de St. Paer	64	Executive Vice President, Chief Financial Officer, Treasurer and Assistant Secretary
Charles F. Barr	56	Executive Vice President and General Counsel
Christopher V. Greetham	61	Executive Vice President and Chief Investment Officer
Clive R. Tobin	56	Executive Vice President of the Company and Chief Executive of Insurance Operations
Henry C.V. Keeling	50	Executive Vice President of the Company and Chief Executive of Reinsurance Operations and Global Head of Business Services
Paul S. Giordano	43	Executive Vice President of the Company and Chief Executive of Financial Products and Services Operations
Anthony E. Beale	63	Senior Vice President, Head of Global Human Resources

Brian M. O'Hara has been President and Chief Executive Officer of the Company since 1994 and a Director of the Company since 1986, having previously served as Vice Chairman of the Company from 1987. He is Chairman of XL Insurance (Bermuda) Ltd and was Chief Executive Officer of XL Insurance (Bermuda) Ltd until 1998, having previously served as Chairman, President and Chief Executive Officer from 1994, President and Chief Executive Officer from 1992 and as President and Chief Operating Officer from 1986.

Fiona E. Luck has been Executive Vice President and Global Head of Corporate Services since November 2004 and Assistant Secretary since January 2002. From 1999 to 2004, Ms. Luck was Executive Vice President of Group Operations of the Company. Ms. Luck was previously employed at ACE Bermuda as Executive Vice President from 1998, and Senior Vice President from 1997. From 1992 to 1997, Ms. Luck was the Managing Director of the Marsh & McLennan Global Broking office in Bermuda.

Jerry M. de St. Paer has been Executive Vice President and Chief Financial Officer of the Company since February 2001. Mr. de St. Paer was appointed Treasurer and Assistant Secretary of the Company in January 2002. Mr. de St. Paer was previously Managing Director of Hudson International Advisors in New York. Prior to forming Hudson International in 1998, he served as Managing Director, Insurance at J.P. Morgan & Company, Inc. Mr. de St. Paer was previously employed at The Equitable (now AXA Financial Advisors), from 1986 until 1997, serving most recently as Senior Executive Vice President and Chief Financial Officer of The Equitable and as Executive Vice President of Strategic Studies and Development of the AXA Group.

Charles F. Barr has been Executive Vice President and General Counsel of the Company since November 2004, having previously served as General Counsel of X.L. America, Inc. from 2002. Before joining the Company, Mr. Barr was General Counsel of Benfield Blanch from 2000 to 2002. Mr. Barr was previously Senior Vice President,

Secretary and General Counsel of General Re Corporation from 1994 to 2000 and Assistant General Counsel from 1989 to 1994. Prior to that he was Senior Vice President and General Counsel of General Accident Insurance Company of America from 1987 to 1989.

Christopher V. Greetham has been Executive Vice President of the Company since December 1998 and has served as Chief Investment Officer of the Company since 1996. Prior to joining the Company, Mr. Greetham served as Senior Vice President and Chief Financial Officer of OIL Insurance Ltd from 1982 to 1996 and as Vice President of Bankers Trust Company from 1975 to 1982.

Clive R. Tobin has been Executive Vice President and Chief Executive of Insurance Operations since April 2004. Mr. Tobin was President and Chief Executive of XL Winterthur International from February 2002, having previously served as Deputy Chief Executive and Chief Underwriting Officer of XL Winterthur International following the Company's acquisition of the risk management business from Credit Suisse in 2001, and President and Chief Executive of XL Insurance (Bermuda) Ltd since July 1999. From 1995 to 1999, Mr. Tobin held a variety of senior management positions at XL. Prior to joining XL in 1995, Mr. Tobin served as President of Rockefeller Insurance Company and Acadia Risk Management Services, Inc., in New York. From 1979 to 1986, Mr. Tobin served as Vice President of Risk Management Services for Marsh & McLennan, Inc.

Henry C.V. Keeling was Executive Vice President of the Company (EVP) and Chief Executive of Reinsurance Operations from July 2000 until November 2004 when he was appointed EVP, Chief Executive of Reinsurance Operations and Global Head of Business Services, and January 2006 when he became EVP, Chief Global Head of Business Services and Chief Executive, Reinsurance Life Operations. Mr. Keeling was Chief Executive Officer of XL Re Ltd since August 1998. Mr. Keeling was President and Chief Operating and Underwriting Officer of Mid Ocean Re (now known as XL Re Ltd) from 1992 to 1998. He previously served as a director of Taylor Clayton (Underwriting Agencies) Ltd and deputy underwriter for Syndicate 51 at Lloyd's from 1984 through 1992.

Paul S. Giordano has been Executive Vice President and Chief Executive of Financial Products and Services since November 2004. Mr. Giordano served as General Counsel of the Company from January 1997 to November 2004. Mr. Giordano was associated with Cleary, Gottlieb, Steen & Hamilton and Clifford Chance in New York and London prior to joining the Company.

Anthony E. Beale has been Senior Vice President, Head of Global Human Resources since he joined the Company in September 2000. Mr. Beale was Managing Director at Santander Investment Securities from 1997 to 1999. Mr. Beale previously served as Managing Director of J.P. Morgan until 1997.

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

The Company's Class A ordinary shares, \$0.01 par value, are listed on the New York Stock Exchange under the symbol [XL].

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

	<u>High</u>	<u>Low</u>	<u>Close</u>
2005:			
1st Quarter	\$79.80	\$70.89	\$72.37
2nd Quarter	76.05	67.40	74.42
3rd Quarter	74.99	64.95	68.03
4th Quarter	74.44	60.03	67.38
2004:			
1st Quarter	\$81.54	\$72.44	\$76.04
2nd Quarter	79.55	73.92	75.46
3rd Quarter	75.99	68.87	73.99
4th Quarter	79.56	67.62	77.65

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

The number of record holders of Class A ordinary shares as of December 31, 2005 was 932. This figure does not represent the actual number of beneficial owners of the Company's Class A ordinary shares because such shares are frequently held in [street name] by securities dealers and others for the benefit of individual owners who may vote the shares.

In 2005, four quarterly dividends were paid at \$0.50 per share to all ordinary shareholders of record as of March 10, June 9, September 8 and December 8. In 2004, four regular quarterly dividends were paid at \$0.49 per share to all ordinary shareholders of record as of March 8, June 7, September 6 and December 6.

Management has recommended that the Board of Directors reduce the future quarterly dividend payable on the Company's Class A ordinary shares to \$0.38 per share.

On January 27, 2006, the Board of Directors declared a quarterly dividend of \$0.38 per share payable on March 31, 2006 to shareholders of record on March 15, 2006.

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

As a holding company, the Company's principal source of income is dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of

the various countries that the Company operates in, including Bermuda, the United States and the U.K., and those of the Society of Lloyd's, and certain contractual provisions. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8, Note 24 to the Consolidated Financial Statements for further discussion.

Rights to purchase Class A ordinary shares ("Rights") were distributed as a dividend at the rate of one Right for each Class A ordinary share held of record as of the close of business on October 31, 1998. Each Right entitles holders of Class A ordinary shares to buy one ordinary share at an exercise price of \$350. The Rights would be exercisable, and would detach from the Class A ordinary shares, only if a person or group were to acquire 20% or more of the Company's outstanding Class A ordinary shares, or were to announce a tender or exchange offer that, if consummated, would result in a person or group beneficially owning 20% or more of Class A ordinary shares. Upon a person or group without prior approval of the Board acquiring 20% or more of Class A ordinary shares, each Right would entitle the holder (other than such an acquiring person or group) to purchase Class A ordinary shares (or, in certain circumstances, Class A ordinary shares of the acquiring person) with a value of twice the Rights exercise price upon payment of the Rights exercise price. The Company will be entitled to redeem the Rights at \$0.01 per Right at any time until the close of business on the tenth day after the Rights become exercisable. The Rights will expire at the close of business on September 30, 2008, and do not initially have a fair value. The Company has initially reserved 119,073,878 Class A ordinary shares being authorized and unissued for issue upon exercise of Rights.

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

Purchases of Equity Securities by the Issuer and Affiliate Purchases

The following table provides information about purchases by the Company during the quarter ended December 31, 2005 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased (1)	Average Price Paid per share (2)	Total Number Of Shares Purchases as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (3)
October	7,486	73.88		\$135.4 million
November	997	68.09		\$135.4 million
December	1,837	66.31		\$135.4 million
Total	10,320	71.97		\$135.4 million

(1) All of the shares included in each period were purchased in connection with the vesting of restricted shares granted under the Company's restricted stock plan. All of these purchases were made in connection with satisfying tax withholding obligations of those employees. These shares were not purchased as part of the Company's publicly announced share repurchase program.

(2) The price paid per share is the closing price of the shares on the vesting date.

(3) On January 9, 2000, the Board of Directors previously authorized a \$500.0 million share repurchase program. The Company did not repurchase any equity securities under the program during the year ended December 31, 2005. As of December 31, 2005 the Company could repurchase up to approximately \$135.4 million of the Company's equity securities under the Company's share repurchase program.

ITEM 6. SELECTED FINANCIAL DATA

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

	<u>2005(1)</u>	<u>2004(1)</u>	<u>2003(1)</u>	<u>2002(1)</u>	<u>2001</u>
<i>(U.S. dollars in thousands, except share and per share amounts and ratios)</i>					
Income Statement Data:					
Net premiums earned □					
general operations	\$ 6,873,638	\$ 6,987,940	\$ 6,089,578	\$ 4,889,867	\$ 2,706,541
Net premiums earned □					
financial operations	254,136	228,898	195,344	162,357	73,386
Net premiums earned □ life					
and annuity operations	2,237,721	1,365,176	708,994	990,736	695,595
Net investment income	1,475,039	1,035,012	815,487	758,358	624,914
Net realized gains (losses) on					
investments	241,882	246,547	120,195	(214,160)	(93,237)
Net realized and unrealized					
gains (losses) on derivative					
instruments	28,858	73,493	6,073	(41,546)	13,041
Net income from investment					
affiliates (2)(7)	154,844	124,008	119,200	54,143	80,580
Fee income and other	19,297	35,317	41,744	54,963	18,247
Net losses and loss expenses					
incurred □					
general operations	7,358,929	4,796,855	4,595,992	3,358,955	2,885,339
Net losses and loss expenses					
incurred □					
financial operations	106,072	114,633	100,435	69,477	33,559
Claims and policy benefits □					
life operations	2,479,364	1,480,535	791,454	1,031,704	698,675
Acquisition costs, operating					
expenses					
and foreign exchange gains					
and losses	2,188,357	2,277,321	1,926,393	1,549,440	1,073,903
Interest expense	403,849	292,234	233,929	190,442	125,298
Amortization of intangible					
assets	10,752	15,827	4,637	6,187	58,569
(Loss) income before minority					
interests,					
net income from operating					
affiliates					
and income tax expense	(1,261,908)	1,118,986	443,775	448,513	(756,276)
Preference share dividends	40,322	40,321	40,321	9,620	□
Net (Loss) income available to					
ordinary shareholders	\$ (1,292,298)	\$ 1,126,292	\$ 371,658	\$ 395,951	\$ (576,135)
Per Share Data:					
	\$ (9.14)	\$ 8.17	\$ 2.71	\$ 2.92	\$ (4.55)

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Net (loss) income per ordinary share □ basic (3)						
Net (loss) income per ordinary share □ diluted (3)	\$ (9.14)	\$ 8.13	\$ 2.69	\$ 2.88	\$ (4.55)	
Weighted average ordinary shares						
Outstanding □ diluted (3)	141,406	138,582	138,187	137,388	126,676	
Cash dividends per ordinary share	\$ 2.00	\$ 1.96	\$ 1.92	\$ 1.88	\$ 1.84	

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	<u>2005(1)</u>	<u>2004(1)</u>	<u>2003(1)</u>	<u>2002(1)</u>	<u>2001</u>
<i>(U.S. dollars in thousands, except share and per share amounts and ratios)</i>					
Balance Sheet Data:					
Total investments available for sale	\$ 35,724,439	\$ 27,823,828	\$ 20,775,256	\$ 16,059,733	\$ 12,429,845
Cash and cash equivalents	3,693,475	2,203,726	2,722,405	3,595,782	2,201,723
Investments in affiliates	2,046,721	1,936,852	1,903,341	1,750,005	1,113,344
Unpaid losses and loss expenses recoverable	6,441,522	6,971,356	6,045,025	5,223,966	4,803,248
Premiums receivable	3,799,041	3,838,228	3,487,322	3,592,713	2,182,348
Total assets	58,454,901	49,245,469	41,455,745	35,971,325	28,508,129
Unpaid losses and loss expenses	23,767,672	19,837,669	16,763,124	13,332,502	11,806,745
Unearned premiums	5,388,996	5,191,368	4,729,989	4,028,299	2,636,428
Notes payable and debt	3,412,698	2,721,431	1,905,483	1,877,957	1,604,877
Shareholders' equity	8,471,811	7,738,695	6,936,915	6,569,589	5,437,184
Book value per ordinary share	\$ 44.31	\$ 51.98	\$ 46.74	\$ 44.48	\$ 40.35

Operating Ratios:

Loss and loss expense ratio (4)	107.1%	68.6%	75.5%	68.6%	106.6%
Underwriting expense ratio (5)	25.8%	27.3%	27.3%	28.9%	33.8%
Combined ratio (6)	132.9%	95.9%	102.8%	97.5%	140.4%

- (1) Results for all periods subsequent to July 1, 2001 include the results of Winterthur International, which was acquired with effect from this date. The results also include the consolidation of XL Re Europe, which has been accounted for as a subsidiary with effect from January 1, 2002. In the year ended December 31, 2001 the Company's share of net income of Le Mans Ré (now known as XL Re Europe) was included in equity in net income of operating affiliates. The Company's net income for the years ended December 31, 2001 and after was impacted by the September 11 event. The effect of all of these items should be considered when making period to period comparisons of the Company's results of operations and financial condition and liquidity. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion and analysis.
- (2) Net income from investment affiliates in 2003 includes income on the alternative investment portfolio for eleven months ended November 30, 2003 as compared to the twelve months ended December 31 in prior years and the twelve months ended November 30 in subsequent years. The fair market values of certain of these alternative investments often take longer to obtain as compared to the other of our investments and we record the investment affiliates on a one month lag in order for us to meet the accelerated filing deadlines as specified by the SEC.
- (3) Net income per ordinary share is based on the basic and diluted weighted average number of Class A ordinary shares and share equivalents outstanding for each period. Net loss per ordinary share is based on the basic weighted average number of ordinary shares outstanding.
- (4) The loss and loss expense ratio is calculated by dividing the losses and loss expenses incurred by the net premiums earned for general insurance and reinsurance operations.
- (5) The underwriting expense ratio is the sum of acquisition expenses and operating expenses for general insurance and reinsurance operations divided by net premiums earned for general insurance and reinsurance operations. See Item 8, Note 3 to the Consolidated Financial Statements for further information.
- (6) The combined ratio is the sum of the loss and loss expense ratio and the underwriting expense ratio. A combined ratio under 100% represents an underwriting profit and over 100% represents an underwriting loss.
- (7) Certain reclassifications to prior period information have been made to conform to current year presentation.

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

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

As further described in Note 29 to the 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. 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 Company's 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 2003 will be reduced to \$2.8 billion (from \$3.4 billion previously reported), for 2004 has been reduced to \$3.9 billion (from \$4.4 billion previously reported), for 2005 has been increased to \$5.0 billion (from \$4.2 billion previously reported) and for the first six months of 2006 will be reduced to \$0.8 billion (from \$1.3 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 restatement of the Company's Consolidated Statements of Cash Flows will not impact the Company's 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 Company's Consolidated Statements of Cash Flows remains unchanged.

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

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

Executive Overview

The Company operates on a global basis primarily in the property and casualty industry and, to a lesser extent, the financial services industry. The Company serves the insurance, reinsurance and financial services needs of institutional and corporate clients, typically the global equivalent of the Fortune 2000. The Company operates in markets where the Company believes its underwriting expertise and financial strength represent a relative advantage. The Company does not operate in any retail markets.

The property and casualty insurance and reinsurance markets have historically been cyclical, meaning that based on market conditions, there have been periods where premium rates are high and policy terms and conditions are more favorable (a "hard market") to the Company and there have been periods where premium rates decline and policy terms and conditions are less favorable (a "soft market") to the Company. This has been driven primarily by competition in the marketplace, the supply of capital in the industry, investment yields and the frequency and severity of loss events. Management's goal is to build long-term shareholder value by capitalizing on current opportunities and managing through any potential downward cycles by reducing its property and casualty book of business and exposures if and when rates deteriorate to unprofitable levels for the Company. As part of its long-term strategy, the Company also looks to its financial products and services segment to provide a diversified stream of earnings that are not directly tied to the property and casualty cycle. In this regard, the Company's financial guaranty operations have substantially achieved relative trading parity with its peers.

The Company has grown through acquisition activity and development of new business opportunities. Acquisitions included Global Capital Underwriting Ltd in 1996, Mid Ocean Limited in 1998, ECS, Inc. and NAC Re Corp. in 1999, Winterthur International in 2001 and Le Mans Ré in 2002. All acquisitions have supported the Company's strategic plan to develop a global platform in insurance and reinsurance. Recent business developments include XL Capital Assurance Inc. and XL Financial Assurance Ltd., the Company's financial guaranty primary and reinsurance guarantors, XL Weather & Energy Inc. and XL Life Insurance & Annuity Company. As a result of these combined developments, the Company now competes as an integrated global business with more than 3,500 employees in 29 countries.

The Company earns its revenue primarily from net premiums written and earned. Premium rates in the property and casualty industry began to increase in 2001 following five years of poor underwriting performance in the industry. These price increases were further compounded by the September 11 event. In the three years ended December 31, 2003, the Company experienced pricing increases and improved terms and conditions across most of the lines of business it writes. These generally across-the-board price increases were unprecedented, meaning that, in the past, pricing increases and more favorable terms and conditions were not experienced across all of the Company's product lines at one point in any one cycle.

During 2004, property and casualty market conditions overall remained attractive although price competition increased throughout the year, most notably in regards to property and professional lines. Accordingly, the Company continued to focus on disciplined risk selection. In relation to insurance and reinsurance, downward pressure on rates across most non-catastrophe exposed lines continued throughout 2005 although the impact of the 2004 storm season, the backdrop of continued emergence of adverse development related to the market of the late 1990s and concerns about reinsurer financial strength, all served to reinforce a sense of discipline in the market.

Subsequent to the unprecedented catastrophic losses in 2005 and into the 2006 first quarter renewals, the market in general has seen an improvement in terms and conditions as well as pricing, in particular in geographic territories and classes impacted by the catastrophe losses. Casualty and professional lines, which have seen significant price reductions in 2004 and 2005, have begun to stabilize. In the Reinsurance segment, however, these improvements have been offset somewhat by increased ceding company retentions which is common in a hardening market. While the Company is not focused on top line premium growth unless it is profitable and meets demanding standards and internal hurdle rates, the Company's expectation is for flat earned premium growth for the full year of 2006, with insurance contributing flat to low single digit growth and reinsurance contributing flat to mid-single digit declines.

The Company also generates revenue from investment activities through returns on its investment portfolio. The Company's current investment strategy seeks to support the liabilities arising from the operations of the Company, generate investment income and build book value over the longer term. During both 2005 and 2004, interest rates in the U.S. increased. During 2005, the U.S. yield curve flattened significantly, as short to medium term rates increased significantly while long-term rates showed a small decline. The benchmark 90-day treasury rose from 2.22% to 4.08% and the 5-year treasury rose from 3.61% to 4.35%, while the 30-year treasury fell from 4.83% to 4.54%. Interest rates declined in the U.K., where the yield on the benchmark 5-year Gilt fell from 4.49% to 4.17%, however, in the Euro-zone, the yield on the benchmark 5-year German Bund rose slightly from 3.03% to 3.07%.

The Company expects net investment income to rise in 2006 supported by positive cash flow from operating activities and anticipated moderate increases in market interest rates.

In 2005, the Company generated net realized gains from both its equity and fixed income portfolios, reflecting the current and accumulated performance of the capital markets. In 2004, the Company generated net realized gains from both its equity and fixed income portfolios reflecting the overall performance of capital markets and the deterioration of the U.S. dollar relative to foreign currencies. In 2003, the Company generated net realized gains from both its equity and fixed income portfolios reflecting the overall improvement in capital markets and narrowing of credit spreads.

The Company's profitability in any given period is based upon its premium and investment revenues as noted above, less net losses incurred and expenses. Net losses incurred are based upon claims paid and changes to unpaid loss reserves. Unpaid loss reserves are estimated by the Company and include both reported loss reserves and reserves for losses incurred but not reported. The Company's results for 2005 were significantly impacted by the unprecedented insured hurricane losses during the 2005 Atlantic hurricane season, the charge related to the conclusion of the independent actuarial process with Winterthur Swiss Insurance Company and adverse development of prior year loss reserves in both insurance professional lines and reinsurance casualty lines. The Company's results for 2004 were also significantly impacted by the catastrophe activity in the year, which resulted in \$591.2 million in estimated net loss and loss expenses, combined with adverse prior year development in certain lines of the Company's insurance segment. For a further discussion of these events see "Results of Operations" below.

Financial measures

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

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Underwriting (loss) profit \square general operations	\$ (2,268,164)	\$ 343,990	\$ (112,594)
Combined ratio \square general operations	132.9%	95.9%	102.8%
Investment income \square general operations	\$ 798,805	\$ 614,128	\$ 542,074
Book value per ordinary share	\$ 44.31	\$ 51.98	\$ 46.74
Return on average ordinary shareholders' equity	NA	16.5%	6.0%

Underwriting profit (loss) \square general operations

One way that the Company evaluates the performance of its 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. As noted above, the Company's underwriting profit and loss for the last three years have been negatively impacted by net losses incurred from catastrophic losses, the results of the independent actuarial process with Winterthur Swiss Insurance Company and adverse development of prior year loss reserves. Partially offsetting this has been the addition of certain new business lines, the increase in premium rates in 2003 and favorable underwriting terms and conditions. Any changes to loss reserves affect the calculation of underwriting profit or loss but most often do not directly affect the Company's cash flow in the same period. See further discussion below. Barring any unusual catastrophic loss events, the Company expects to produce an underwriting profit in 2006.

Combined ratio \square general operations

The combined ratio for general operations is used by the Company and many other insurance and reinsurance companies as another measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net premiums earned for the Company's general insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and over 100% indicates an underwriting loss. The Company's combined ratio for the last three years have been negatively impacted by the factors affecting the underwriting profit (loss), noted above.

Net investment income \square general operations

Net investment income from its general operations is an important measure that affects the Company's overall profitability. The largest liability of the Company relates to its unpaid loss reserves and the Company's investment portfolio provides liquidity for claims settlements of these reserves as they become due, and thus a significant part of the portfolio is in fixed income securities. Net investment income is primarily affected both by the size of the portfolio and the level of market interest rates. In 2005, the U.S. yield curve flattened significantly with U.S. short to medium term interest rates increasing markedly while long term rates showed a small decline. U.K. rates declined, while in the Euro-zone short term rates rose while medium to long term rates declined. In 2004, U.S. interest rates increased moderately while interest rates in the U.K. and Euro-zone declined. The size of the portfolio is also impacted by cash flow generated from operations and financing, which has been positive during the last three years and which the Company currently expects to be positive in 2006.

Book value per ordinary share

Management also views the change in the Company's book value per ordinary share as an additional measure of the Company's performance. Book value per share is calculated by dividing ordinary shareholders' equity by the number of outstanding ordinary shares at any period end. Book value per ordinary share is affected primarily by

the Company's net income and also by any changes in the net unrealized gains and losses on its investment portfolio. The Company's book value per ordinary share decreased in 2005 as a result of the underwriting losses incurred, partially offset by the significant capital-raising during December 2005, where ordinary shares were issued at a premium to the book value at that time. During 2005, book value per share also decreased as a result of a decrease in the unrealized gains on the Company's investment portfolio. The decrease was primarily as a result of increasing short to medium term U.S. interest rates, partially offset by declining longer term U.K. interest rates. The Company's book value per ordinary share increased in 2004, primarily as a result of an increase in net income combined with an increase in the net unrealized gains on the investment portfolio. The increase in unrealized gains on the Company's fixed income portfolio was primarily a result of the foreign exchange benefits for non-U.S. dollar investments partially offset by a moderate increase in interest rates in the U.S.

Return on average ordinary shareholders' equity

Return on average ordinary shareholder's equity ("ROE") is a widely used measure of any company's profitability. It is calculated by dividing the net income for any period by the average of the opening and closing ordinary shareholders' equity. The Company establishes minimum target ROEs for its total operations, segments and lines of business. If the Company's minimum ROE targets over the longer term are not met with respect to any line of business, the Company seeks to modify and/or exit these lines. In addition, the Company's compensation of its senior officers is significantly dependent on the achievement of the Company's performance goals to enhance shareholder value as measured by ROE. The Company reported a loss in 2005 and ROEs for the prior two years have been negatively affected mainly by its general operations' underwriting results and investment income.

Other Key Focuses of Management

Ratings and Capital Management

The Company's ability to underwrite business is largely dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Company's financial strength rating is downgraded, its ability to write business will be adversely affected. Such a downgrade would also adversely affect the Company's financial guaranty lines of business. During the third and fourth quarters of 2005 a number of ratings actions were taken by independent rating agencies including some downgrades of the Company's principal insurance and reinsurance subsidiaries. The Company subsequently raised \$3.2 billion through an issuance of a combination of ordinary shares and equity security units. The financial strength ratings of the Company's financial guaranty companies remain "triple A" with a stable outlook (by Standard & Poor's, Moody's and Fitch Ratings). For a further discussion see "Ratings" above.

To address rating agency requirements regarding the differential between the triple-A ratings of the Company's financial guaranty companies and their affiliated companies, management is currently exploring a number of strategies that would provide greater independence and stability to XLCA's and XLFA's ratings. Examples of actions identified by the rating agencies are, among other things, the inclusion of additional independent directors to the boards of directors of the Company's financial guaranty companies; adding some level of outside high-quality ownership with voting and/or veto rights; and securing a resolution from each of the boards of directors of the Company's financial guaranty companies that clarifies our expectations regarding cash payments from the financial guaranty companies. S&P has stated that one or more of these actions will need to be taken by mid-year 2006.

In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claims paying and financial strength ratings. In response to the unprecedented insured hurricane losses during the 2005 Atlantic hurricane season, the loss related to the conclusion of the independent actuarial process with WSIC, rising capital requirements for the property catastrophe business from rating agencies and the currently anticipated growth in business to be written in 2006, the Company raised \$3.2 billion in capital through the issuance of a combination of ordinary shares and equity security units. In addition, the Company has implemented several key business initiatives with ratings and capital management implications.

1. Management has entered into a strategic initiative intended to augment the Company's overall underwriting capacity to take advantage of opportunities in certain catastrophe-exposed lines of business. Management has entered into a collateralized quota share reinsurance treaty with Cyrus Reinsurance Limited. Under this agreement, as of January 1, 2006, the Company cedes specified

portions of the Company's property catastrophe reinsurance and retrocession lines of business.

2. Management continues to reduce the Company's net catastrophe exposed risks. In the Insurance segment, management continues to reduce exposure to accounts that have the potential for significant volatility under wors-

ening catastrophe event scenarios, reduce catastrophe sublimits and eliminate accounts that no longer meet the Company's increased pricing needs. In addition to the strategic initiative noted above, the Reinsurance segment's management intends to reduce catastrophe exposure within the property risk portfolio and restructure the way in which marine excess of loss programs are written.

Operational Efficiency and Effectiveness

The Company's ability to compete is influenced by its operational efficiency and effectiveness, including the development and retention of its people. In recognition of this, the Company has in place and continues to develop, programs and initiatives aimed at enhancing its position in these areas. For example, the Company continues to make significant investments in information technology in both the Insurance and Reinsurance segments, develop and implement a new framework for Financial Reporting and Controls, and establish an operations center, based in, India. Each of these projects requires considerable investment and commitment of the Company's resources in an effort to achieve the ultimate goals of increased operational efficiency and effectiveness.

Collateral Management

Another important matter on which management is focused (and which also affects the Company's ability to underwrite business) is the availability of collateral. Collateral includes letters of credit, insurance trusts and other credit facilities required to provide security to cedants (which are companies who reinsure their liabilities to the Company), particularly as required by state insurance regulation in the U.S. and at Lloyd's, and also to provide the Company with liquidity as required. These facilities are provided to the Company from commercial banks. Our principal credit facilities have tenors of two, three, and five years. The Company has also utilized "off balance sheet" transactions in order to obtain more collateral capacity (these transactions are described below under "Variable Interest Entities and Other Off Balance Sheet Arrangements"). As the Company writes more business, its collateral requirements will increase. A key challenge for management is to ensure that sufficient collateral capacity is available as to not hinder future writing of business.

Liquidity and cash flow

As a property and casualty insurer, the Company must ensure that it has sufficient funds to settle claims promptly, especially upon the occurrence of a major catastrophic event. Management is focused on making sure that liquidity requirements are supported by having lines of credit facilities available to the Company as well as by the Company's general investment portfolio of which the majority is in high grade fixed income securities. The Company has had significant positive cash flow from operations in the three years ended December 31, 2005 generated from its underwriting activities (premiums less claim and expense settlements) as well as the receipt of investment income on its portfolio. In addition during 2005, capital raising activity provided significant cash flows from financing activities. The Company expects cash flow from operations to be positive in 2006.

Results of Operations

The following table presents an analysis of the Company's net income available to ordinary shareholders and other financial measures (described below) for the years ended December 31, 2005, 2004 and 2003:

<i>(U.S. dollars in thousands, except share and per share amounts)</i>	2005	2004	2003
Net (loss) income available to ordinary shareholders	\$ (1,292,298)	\$ 1,126,292	\$ 371,658
(Loss) earnings per ordinary share □ basic	\$ (9.14)	\$ 8.17	\$ 2.71
(Loss) earnings per ordinary share □ diluted	\$ (9.14)	\$ 8.13	\$ 2.69
Weighted average number of ordinary shares and ordinary share equivalents □ basic	141,406	137,903	136,906
Weighted average number of ordinary shares and ordinary share equivalents □ diluted	141,406	138,582	138,187

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

- 1) Significant large catastrophe activity;
- 2) The impact of the unfavorable result of the independent actuarial process with Winterthur Swiss Insurance Company;
- 3) Net adverse prior year loss development in general insurance and reinsurance operations;
- 4) Growing asset base and positive performance from investments in affiliates.

1. Significant large catastrophe activity (Hurricanes Katrina, Rita and other natural catastrophes)

During the third and fourth quarters of 2005, there was an unprecedented number of natural catastrophes. In August 2005, Hurricane Katrina, a Category 4 storm, hit the Gulf Coast of the United States and is estimated to have caused the largest ever insured loss from a natural disaster in the property and casualty insurance industry. In September 2005, Hurricane Rita, a Category 3 storm, hit the Gulf Coast on the United States and caused considerable damage, although Rita was less severe than Katrina. In October 2005, Hurricane Wilma hit South Florida after causing significant damage in Mexico and Cuba. In addition, there were several other natural loss events in the third and fourth quarter 2005, including hurricanes Dennis, Emily and Ophelia, the European and Mumbai Floods and Typhoon Mawar (collectively, the "Other Cats"). Collectively, Hurricanes Katrina, Rita, Wilma, and these Other Cats have had a substantial impact on the Company's results of operations and financial condition.

As a result of the substantial impact the Hurricanes Katrina, Rita, Wilma and the Other Cats have had on the results of the Company for the year ended December 31, 2005, the Company has estimated losses incurred, net of reinsurance recoveries, of \$1.27 billion, \$357.9 million and \$247.1 million and \$96.0 million, respectively, based on preliminary reports and estimates of such loss and damage. The Company has performed an analysis of contracts it believes are exposed to these catastrophes and, together with other preliminary information received from insureds and cedents and industry models, has determined its best estimates at this time for the expected ultimate loss. Actual losses may vary materially from this estimate based on a number of factors, including receipt of additional information from insureds or brokers, the attribution of losses to coverages and/or layers that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. In addition, the loss estimate includes a high level of uncertainty related to, among other things, complex coverage issues associated with Hurricanes Katrina, Rita and Wilma and potential legal developments that may result in ultimate losses not being known for a considerable period of time. Therefore, losses may ultimately be materially greater or lesser than the current estimate and accordingly impact future financial results. Losses in connection with these events were incurred almost equally from the Company's Insurance and Reinsurance segments.

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The year ended December 31, 2004 was negatively impacted by four hurricanes, Frances, Charley, Ivan and Jeanne, for a total net loss of \$516.6 million, net of reinsurance recoveries. In addition, the Company incurred net losses and loss expenses of \$74.6 million in 2004 as a result of the earthquake and the subsequent tsunami that struck South Asia on December 26, 2004.

The following are analyses of the financial impact on the Company's results of operations for the years ended December 31, 2005 and 2004 from natural catastrophes:

	Year ended			
	December 31, 2005			
	<i>(U.S. dollars in millions, except ratios)</i>			
	Insurance	Reinsurance	Financial Products and Services	Total
Operating Data:				
Net premiums earned				
Katrina	\$ (74.6)	\$ 16.3	\$ 23.6	\$ (34.7)
Rita	(13.3)	8.8	□	(4.5)
Wilma	(1.2)	6.2	□	5.0
Other natural catastrophes*	□	3.4	□	3.4
Total net premiums earned	\$ (89.1)	\$ 34.7	\$ 23.6	\$ (30.8)
Gross losses and loss expenses:				
Katrina	1,339.7	1,128.0	45.0	2,512.7
Rita	521.9	232.4	□	754.3
Wilma	172.7	214.4	□	387.1
Other natural catastrophes*	40.2	57.5	□	97.7
Total gross losses and loss expenses	\$ 2,074.5	\$ 1,632.3	\$ 45.0	\$ 3,751.8
Losses and loss expenses recoverable:				
Katrina	748.6	495.3	□	1,243.9
Rita	312.9	83.5	□	396.4
Wilma	64.3	75.7	□	140.0
Other natural catastrophes*	1.7	□	□	1.7
Total losses and loss expenses recoverable	\$ 1,127.5	\$ 654.5	\$ □	\$ 1,782.0
Underwriting loss	\$ (1,036.1)	\$ (943.1)	\$ (21.4)	\$ (2,000.6)
Income tax benefit				\$ 135.5
Net loss				